Comments of Consumer Watchdog

California Department of Insurance Rulemaking Hearing Regarding Catastrophe Modeling and Ratemaking August 16, 2024 Proposed Regulation Text

REG-2023-00010

September 17, 2024

INTRODUCTION

Commissioner Lara proposes to allow insurance companies to use unverifiable black box models to set rates, charge consumers for unregulated reinsurance, and roll back regulatory oversight that has protected consumers for nearly four decades.

These measures, proposed by the insurance industry in response to an availability crisis the insurance industry created, will make insurance premiums even more unaffordable for consumers across the state.

They will also fail to stabilize access to coverage in California. Despite similar concessions in Florida, home insurance rates are at least two-and-a-half times higher than in California,[1] Florida's insurer of last resort has four times as many policyholders as the FAIR Plan,[2] and insurance companies have still abandoned the state.

The proposed regulation—based on a legislative proposal negotiated between Commissioner Lara and insurance companies behind closed doors last year—was supposed to make insurance companies give something back by requiring them to sell home insurance again to Californians they have abandoned. It was also supposed to provide robust public review of models so consumers, communities, and policymakers can be confident that insurance companies are treating consumers fairly.

It is deeply disappointing that the long-awaited text of the regulation fails on both counts. The proposed regulation will not require expanded access to insurance for Californians. It also does not create any meaningful review of the private black box catastrophe models insurance companies want to use to raise rates. Instead, the proposal is riddled with loopholes and

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[1] Nat. Assn. of Ins. Comrs., *Dwelling Fire, Homeowners Owner-Occupied, and Homeowners Tenant and Condominium/Cooperative Unit Owner's Insurance Report: Data for 2021* (Dec. 2023), https://content.naic.org/sites/default/files/publication-hmr-zu-homeowners-report.pdf.

[2] Fla. Off. of Ins. Reg., Personal and Commercial Residential Policy Data, https://floir.com/tools-and-data/residential-market-share-reports.

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limitations that will result in massive unjustified rate hikes on homeowners, renters, and small businessowners without improving access to coverage.

Proposed Section 2644.4.8 does not require a single insurance company to sell more wildfire coverage.

- Insurance companies won't have to expand sales to 85% of consumers in distressed areas. They may opt instead to increase their market share in distressed areas by just 5%, *or* take the third option of an "alternative commitment" of their own choosing.
- Insurance companies won't have to sell comprehensive coverage. They may offer a bare-bones policy equivalent to what consumers can already get today on the FAIR Plan.
- Rate hikes start on Day 1, but insurers won't report progress toward commitments for two years—until at least 2027.
- After two years, an insurer may defer meeting a commitment indefinitely, as long as it claims to be making a "reasonable effort."
- There are no penalties if a company fails and no timelines for completion.

Catastrophe models are notoriously inaccurate, inconsistent, and contain biases that can reinforce discriminatory insurance practices. **Yet Proposed Section 2648.5 fails to enact substantive review or approval of models so consumers can have confidence their rates are fair.** Instead, the regulation:

- Creates a process designed to keep model information private, violating Prop 103's unconditional public disclosure and independent scrutiny requirements.
- Does not set uniform standards, or require wildfire models be proven reliable, predictable, and unbiased before they can be used.
- Does not require review or approval of models; the purpose of a Pre-Application Required Information Determination ("PRID") is solely to determine what information will be disclosed.
- Contains no guidelines for minimum information to be made public; required disclosures will be different for every model.
- Actively discourages public participation and independent review of models by experts.
- The whole process is voluntary, and any model currently in use is exempted entirely for up to four years.

Models will simply be tools for insurance companies to charge policyholders more unless California mandates transparency into how they impact prices, imposes rules of the road requiring review and approval of their design and use, and requires that insurance companies use them to provide consumers and communities with actionable information about their own climate risk.

A public model—with no mandate for data secrecy—is the best way to meet these goals.

Consumer Watchdog is one of many public interest organizations that have urged the Commissioner to embrace creation of a public model in prior workshops. While the Initial Statement of Reasons responded to concerns raised in those workshops by many insurance companies and modeling firms with changes to the regulation, the only response to consumer groups was a note that the regulation will not prohibit a public model. Commissioner Lara made no effort to investigate this option.

The misuse of big data, algorithms and artificial intelligence is the focus of intense scrutiny by policymakers in California and across the country. This regulation takes California in the wrong direction.

By bending over backwards to keep models secret, the proposed regulation will lead to unreliable and discriminatory rates, deny consumers and communities the credit they deserve for wildfire mitigation efforts, and authorize models that do not accurately reflect the changing climate risk.

We urge the Commissioner to rethink this failed approach. To ensure that rates and premiums are fair the Department of Insurance must: require public access to any model that impacts rates; mandate standards, testing requirements, and approval of all models; and, thoroughly investigate and actively support the creation of a public model that will better serve all Californians.

Below we provide greater detail about each of these concerns.

PART I: Section 2644.4.8. Distressed Areas; Insurer Commitments

The proposed regulation will drive up rates for every Californian, not just those in wildfire areas.

While the coverage "commitments" do not begin for two years, insurance companies would be able to raise rates using black box models and reinsurance immediately.

The proposed regulation allows insurance companies to use black box catastrophe models to set rates for every Californian. The next regulation on deck will allow insurance companies to charge all policyholders for the unregulated (and skyrocketing) cost of global reinsurance—which no other California commissioner has ever allowed. These two changes will raise rates not just in riskier areas, but for home, condo, and apartment insurance across the state. For example, in North Carolina, one homeowners insurance company's charge on consumers for reinsurance

raised the rate by 46%.[3] In another North Carolina case, the Insurance Commissioner found modeled hurricane losses to be questionable and ordered them reduced by 13.9%.[4]

Companies will begin seeking double-digit rate hikes on these terms soon as the regulations are final; the Commissioner has asserted this will be by the end of this year. However **Proposed Section 2644.4.8(d)** does not require insurance companies to show their progress on their commitments until two years have passed—meaning 2027 at the earliest. As noted in more detail below, this is not a hard deadline.

That means every Californian will pay more for the proposed regulation's empty promise to get homeowners in wildfire areas insured.

The majority of the public does not support that tradeoff, even if it were successful in getting people insured again. A poll conducted by FM3 Research for Consumer Watchdog found that Insurance Commissioner Lara's plan to allow insurance companies to increase premiums for all Californians in exchange for a promise to insure homeowners in higher wildfire risk areas is opposed by a 2 to 1 margin, 62% opposed to 30% in support. Only 9% of voters register in strong support.[5]

Insurance companies do not have to sell comprehensive coverage to meet their commitments.

Ever since Commissioner Lara announced his deal with the insurance industry last September, Consumer Watchdog has asked him to confirm exactly what kind of policy insurance companies would have to sell. This question was urgent because the deal the Commissioner made with the insurance industry during the last legislative session would have allowed the sale of bare bones, FAIR Plan–equivalent policies, not the standard, full-benefit home insurance that Californians need.[6] The Commissioner never answered.

The proposed regulation contains the same loophole. Nothing in the text of the regulation specifies that the policies insurance companies are committing to sell must be standard, full-

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[3] Consumer Watchdog's Preliminary Comments/Questions on NCOR in California Ratemaking Proposal as Presented During CDI Informational Meeting on August 21, 2024, https://consumerwatchdog.org/wp-content/uploads/2024/09/2024-08-30-CWD-Comments_Questions-on-CDI-NCOR-Proposal34.pdf.

[4] Comments by Allan I. Schwartz on behalf of Consumer Watchdog Regarding California Department of Insurance August 23, 2024 Proposed Regulation Text, Catastrophe Modeling and Ratemaking, REG-2023-00010, Sept. 17, 2024, submitted concurrently herewith.

[5] Consumer Watchdog, "New Poll Shows Voters Oppose Commissioner's Home Insurance Plan by 2 to 1," Nov. 16, 2023, https://consumerwatchdog.org/insurance/new-poll-shows-voters-oppose-insurance-commissioners-home-insurance-plan-by-2-to-1-overwhelming-support-requiring-insurers-to-cover-all-who-fire-proof-their-homes/.

[6] Consumer Watchdog letter to Gov. Gavin Newsom et al., Nov. 1, 2023, https://consumerwatchdog.org/wp-content/uploads/2023/11/LtrGovLeg11-1-23.pdf.

benefit insurance coverage that will make sure people can fully rebuild their property and replace their possessions if they experience a loss.

This directly contradicts public expectations and assertions by the Commissioner and Department staff that the policies will be comprehensive.

Proposed Section 2644.4.8(d). The regulation directs companies to commit to sell "policies" with no description of the scope of that coverage.

Proposed Section 2644.4.8. The only other term used in the regulation is "qualifying residential property insurance," as defined in Ins. Code Section 10087, excluding condo owner and tenant policies. That term broadly means a "policy insuring individually owned residential structures of not more than four dwelling units, individually owned condominium units, or individually owned mobilehomes, and their contents, located in this state and used exclusively for residential purposes or a tenant's policy insuring personal contents of a residential unit located in this state."[7]

"Qualifying residential property insurance" could mean an HO-3 comprehensive homeowners policy. It could also mean the "basic property coverage" sold by the FAIR Plan.

A standard HO-3 policy for homeowners covers far more than the limited-benefit FAIR Plan coverage. Among the perils that HO-3 policies cover but are excluded by the FAIR Plan, even with optional add-on coverage, are:

- Theft
- Liability
- Falling objects, such as a tree on the roof
- Non-flood water damage, such as pipes bursting
- The weight of ice or snow
- Glass breakage
- Damage to others' property

When Commissioner Lara recognized the importance of comprehensive policies to homeowners on the FAIR Plan and ordered the Plan to offer broader coverage, the order specified that the Plan must offer "the option of an HO-3 policy or a policy with coverages equivalent to those included in an HO-3 policy."[8]

If the Commissioner's intent were to require insurance companies to sell full-benefit coverage under their commitment, this regulation must also specify the type of policies insurance companies must issue. The proposed regulation does not do so.

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[7] Cal. Ins. Code Section 10087, https://california.public.law/codes/ca_ins_code_section_10087.
[8] *In the Matter of the California FAIR Plan Assn.*, Order No. 2019-2, Nov. 14, 2019, https://www.insurance.ca.gov/0250-insurers/0500-legal-info/0700-commissioners-orders/upload/FAIR-Plan-Order-2019-2.pdf.

Consumers can already buy limited-benefit coverage from the FAIR Plan. This is the jam consumers are trying to get free of. If insurance companies' only commitment under this regulation is to sell bare-bones coverage in return for unjustified rate increases, consumers will be no better off than they are today.

There is no requirement that insurance companies expand sales to 85% of wildfire areas.

Consumer Watchdog has also sought answers on this question since the Commissioner's deal with the industry was announced in September 2023, because the 2023 legislative language would have allowed the Commissioner to exempt any insurance company from its commitments. We asked if insurance companies would be held to an enforceable commitment to increase sales under this new plan, given the clear exceptions in the 2023 deal it was based on. Again, the text of the proposed regulation is clear.

Proposed Section 2644.4.8(d). Rather than meet the standard in (d)(1), a commitment to increase sales in distressed areas to 85 percent of an insurer's market share elsewhere, an insurer "may instead commit" to increasing its policies in distressed areas by as little as 5% of its current business in those areas, on a one-time basis under (d)(2).

This "five percent increment" could amount to very little change for an insurance company that has already dropped most of its customers in fire zones. It perversely rewards those companies that have already abandoned Californians, because if a company's baseline number of policies is small, a 5% increase will be marginal too.

The Initial Statement of Reasons ("ISOR") (p. 37) confirms that insurance companies don't have to meet the 85 percent standard: "This subdivision establishes ***one of two*** standards an insurer may choose as its commitment . . . ." [emphasis added]

Proposed Section 2644.4.8(f). A 5% increase is also the only commitment that commercial insurers must make.

The 5% increase is not limited to small or regional companies.

The Commissioner and Department staff have stated that the 5% increment is limited to small and regional companies that could not meet the 85% standard.[9] However, the text of the regulation does not contain any such limitation.

Even the 5% commitment is an illusion, because insurers have the option of making an "alternative commitment" to choose their own standards.

[9] Cal. Dept. of Ins., "California's Sustainable Insurance Strategy: Insurance Commitments for Wildfire Distressed Areas," June 2024, https://www.insurance.ca.gov/01-consumers/180-climate-change/upload/California-Department-of-Insurance-Presentation-on-Insurance-Commitments-in-Wildfire-Distressed-Areas.pdf.

Proposed Section 2644.4.8(j). At any time, insurance companies may tell the Department of Insurance they cannot meet an 85% or 5% commitment and propose a different commitment.

The justifications for an insurer seeking an "alternative commitment" are undefined. For example, (j)(1)(C) cites "the frequency or severity of recent events impacting the insurer" as a basis for proposing an alternative commitment. The text does not even specify that the recent events must have caused the insurance company financial harm. Such vague terms open the door for any insurance company to demand the right to opt for a lesser "alternative" to either the 85% or 5% increment.

The regulation contains no standards that an acceptable "alternative commitment" must meet.

The regulation states, in (j)(2)(B) in one sentence with no further qualification, that the Commissioner will evaluate an insurance company's proposed alternative commitment based on whether "the alternative increases availability of qualifying residential property insurance and/or commercial property insurance."

Could an insurance company offer to sell a few more policies in a single ZIP code? Increase sales only in non-distressed areas? Start selling Difference In Conditions wraparound coverage, but drop more homeowners' full-benefit policies? Neither the regulation nor the ISOR addresses such questions.

An insurance company could apply for an alternative commitment from Day One. Or it could invoke this alternative commitment option at the two-year mark when it fails to meet the 85% market share or 5% increase commitments. This option creates one avenue to never-ending revisions of an insurance company's commitments.

And **Proposed Section 2644.4.8(g)(3)(C)3.** makes clear that insurance companies, not the Commissioner, will choose the timeline for fulfilment of an alternative commitment.

This "alternative commitment" loophole eliminates even the minimum commitments the regulation otherwise purports to impose.

Multiple additional loopholes and off-ramps let insurance companies off the hook if they fail to meet their commitments.

Proposed Section 2644.4.8(i). An insurance company that has not met the 85% or 5% commitment after two years has only to file an "insurer attestation" that it "is taking reasonable steps to fulfill its insurer commitment." As the regulation does not define what an "insurer attestation" contains, it could be as little as a sentence informing the insurance commissioner whether a company met its commitment or not. "Reasonable steps" is also not defined.

After the attestation, the insurance company is granted an indefinite extension with no requirement or deadline for future reporting or compliance.

<u>Commitments have an expiration date</u>.

Proposed Section 2644.4.8(i). Once an insurance company attests it has met a commitment it is relieved of the obligation of future reporting.

The ISOR (p. 61) states that attestations are only required "until such time as that insurer has attested that it has fulfilled that insurer commitment." In the unlikely event that, despite this regulation's failings, an insurance company does meet a commitment, this language makes clear it is a one-time deal.

This means a company could reverse course and restrict sales right after its attestation was filed.

In addition, **Proposed Section 2644.4.8(d)** states that insurance companies who already meet the 85% standard, and are therefore allowed to make a commitment to maintain that market share "for at least three years," have no obligation beyond the third year. As the ISOR (p. 39) confirms, "the identified time frame is reasonably necessary to address the problem of insurers not knowing how long they have to meet their commitments . . . ."

There is no expectation that an insurance company's commitment to maintain current market share in distressed areas extends beyond the three-year timeframe.

Proposed Section 2644.4.8(h)(1). Another section directs insurance companies to submit a lower "modified insurer commitment" if their market share has decreased.

This encourages insurance companies to continue on the path they're on today. An insurance company that intentionally reduces market share by dropping policyholders would then trigger a re-evaluation (lowering) of the insurance company's commitment. There is no limit on the number of times these commitments can be reduced. Yet the regulation would allow a company that is actively choosing to non-renew policyholders to retain the financial boon of using private models to increase rates.

Proposed Section 2644.4.8(j). A third section allows insurance companies that can't meet their goals to propose the "alternative commitments" outlined above.

There are no timelines for meeting an insurer's commitments, or even reporting on an insurer's progress beyond the first two-year mark, if it says it is "acting in good faith" to comply.

<u>One reason insurance companies are unlikely to meet these commitments is that policies in fire areas will be too expensive for most homeowners to afford</u>.

A very likely outcome of this regulation is that insurance companies will technically offer policies in distressed areas, but that they will price them so prohibitively high that no one will be able to afford them. Insurance companies will then be able to claim they are "taking reasonable steps to fulfill" their goals—because they are offering the policies—but are unable to comply ***because no one can afford to buy them.***

<u>There are no penalties for failure</u>.

Insurance Commissioner Lara has mentioned multiple enforcement mechanisms that are at his disposal: market conduct exams, rate reviews, even refunds.[10] The text of the regulation, however, does not name mandatory or even potential consequences if an insurance company does not meet its commitment at the two-year mark, or at any point in the future, as long as it says it is taking “reasonable steps” to fulfill it.

The regulation does not require the commissioner to investigate failures, order refunds, or take any other enforcement action against an insurer that fails to meet its commitments.

Proposed Section 2644.4.8(h)(2). The regulation does say that an insurance company that renounces its commitment shall no longer use catastrophe models. But since there is no timeline for an insurance company to meet its commitments, plenty of leeway to reduce its commitment when it fails to meet the mark, and no penalty for failure, there is no reason to expect an insurer will ever choose to renounce its commitment.

<u>Companies will not have to prove they met their commitments publicly</u>.

Proposed Section 2644.4.8(c). The only information under the proposed regulation insurance companies must file publicly as part of a complete rate application is notification of what commitment—85%, 5%, or some alternative—they have chosen.

Proposed Section 2644.4.8(g). The proposed regulation requires insurance companies to maintain a “wildfire risk portfolio register” that is meant to track an insurance company’s progress on its commitment. But the regulation does not require the portfolio register to be made public in rate filings or at any other time. The public, policymakers, and the press will have no way of verifying if an insurance company is meeting its commitments.

One potential benefit of such reporting—if it were public, and if insurance companies were in fact meeting their commitments—would be new data to fill the massive existing information gap regarding Californians’ access to coverage. That information could be used to better illuminate for policymakers and the public whether access is improving or getting worse in areas across the state. But no such disclosure is required.

<u>The Commissioner has not disclosed details about how “distressed areas” were identified</u>.

Proposed Section 2644.4.8(a). The regulation defines “distressed areas” to include undermarketed ZIP codes with high fire risk where at least 15% of policies are with the FAIR Plan, or where policies in lower-income ZIP codes cost at least $4 per $1000 in coverage. “Distressed areas” also includes counties where the percentage of high- or very high–risk structures is in at least the 50th percentile of all counties. However, no data or substantive

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[10] Levi Sumagaysay, “California pushes insurers to cover more homes in these areas. Is your ZIP included?” Cal Matters, June 12, 2024, https://calmatters.org/economy/2024/06/california-pushes-insurers-to-cover-more-homes-in-these-areas-is-your-zip-included/.

explanation has been released to show why the Department chose the metrics it did for the ZIP codes and counties considered distressed.

The ISOR does not explain. ISOR (p. 29) states the reason for denoting counties as "distressed" if they have more structures "at high or very high wildfire risk" than half the state (or are "no lower than the 50th percentile") is that "the 60th percentile would be too narrow" while the 40th would be "too broad."

The June draft of the regulation contained a different standard. In that version a county was distressed if at least 20% of dwellings are at high or very high risk. Why did the metric change? The ISOR does not disclose if this change increased or decreased which counties qualify as distressed, and the Commissioner did not issue an updated map of distressed areas with the August draft regulation.

A reasonable metric would be comparing decreases in access to insurance and increases in cost of insurance over time. To what extent—other than FAIR Plan growth—did the Commissioner consider such changes?

The regulation also includes "properties that ***the insurer*** classifies as moderate to very high wildfire risk" [emphasis added] among those policies insurance companies can take on to meet any stated commitment to expand coverage. However, that metric relies on an individual insurance company's measure of wildfire risk. That could vary widely company to company given the variety of internal and external models insurance companies use to assign risk. By including policies classified at moderate risk by an insurance company's own, undisclosed metrics, it is easy to imagine an insurance company meeting its commitment by selling a small number of bare-bones policies to current FAIR Plan policyholders who are not even in high fire risk areas.

If distressed areas are not defined precisely, an insurance company's commitment could be met by sales to consumers not facing cost or access problems in the current crisis, or by too few policies to have any impact. The public should have more evidence of how those areas were identified. The data used by the Department to make these determinations should be made public.

The Commissioner has not disclosed why the "85%" or "5% standard" were chosen as benchmarks.

The ISOR (p. 38) notes that "about 16% of statewide residential exposures were in distressed areas and about half of admitted insurers were already writing at least 85% of their statewide market share in distressed areas." It goes on to note that "a significant number of insurers are currently at approximately 80%."

If so many insurance companies are already at or near the 85% standard, will this regulation simply preserve the status quo when it comes to access to insurance, only with radically higher rates?

Part II: Section 2648.5. Pre-Application Required Information Determination ("PRID") Procedure

I. PUBLIC TRANSPARENCY: The proposed regulation conflicts with Proposition 103's public disclosure requirement.

Transparency is key to confirming that insurance companies have justified their requests for rate increases, which they are required to do under Proposition 103 as part of the prior approval process. Insurance Code section 1861.07 states: "All information provided to the commissioner pursuant to this article [Proposition 103] shall be available for public inspection, and the provisions of Section 6254(d) of the Government Code and Section 1857.9 of the Insurance Code [statutes barring disclosure of information the industry considers trade secrets or proprietary] shall not apply thereto."

Section 1861.07 therefore requires public disclosure of any information provided to the Commissioner in connection with review of an insurer's rate application or otherwise in connection to the Commissioner's powers and duties under Proposition 103. The regulation's attempt to create a procedure designed to segregate information about a model used for determining rates and premiums subject to prior approval under Insurance Code section 1861.05(a) in order to prevent public disclosure is a clear violation of the law, because PRID information is itself "information provided to the commissioner pursuant to [Proposition 103]."

The California Supreme Court has confirmed that there are no exceptions to the disclosure requirement, which applies to "any information necessary for determining whether [underlying] factors are impermissibly affecting the fairness, availability, and affordability of insurance."[11]

Mandatory protective orders and sealing the record prioritize secrecy.

The proposed regulation intentionally moves model consideration out of the public eye in order to exempt models from Proposition 103's transparency requirements. Members of the public, journalists, and lawmakers would be required to enter into an NDA or propose protective orders unilaterally adopted by the Commissioner-appointed Model Advisor as a prerequisite to participating in model oversight and gaining access to all information essential to assessing a model.

The broad NDAs and protective orders mandated in **Proposed Section 2648.5(j)(2)**[12] directly contravene the transparency mandate at the heart of successful rate oversight in California. They instead center the regulation around preserving secrecy in a key aspect of policyholders' rates, a direct violation of Section 1861.07's disclosure mandate. **Proposed Section 2648.5(j)(3)** purporting to give the Model Advisor authority to "balance" the public's

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[11] *State Farm Mut. Automobile Ins. Co. v. Garamendi* (2004) 32 Cal.4th 1029, 1042–1044.

[12] All citations to the proposed regulation text use the lettering of the subdivisions of proposed Section 2648.5 as contained in the August 16, 2024 ISOR. The August 16, 2004 "Proposed Text of Regulation" document issued by the Department contained two subdivisions (a) in error.

interest in disclosure against Wall Street model owners' and insurers' demands for secrecy likewise conflicts with Section 1861.07.

Proposed Sections 2648.5(a)(7) and 2648.5(e) also purport to shield the entire administrative record created in the new PRID procedure from public view (including all evidence, testimony, briefs, pleadings, discovery, and other materials), except whatever information the Model Advisor decides must be submitted to the Commissioner as part of a complete rate application. Even that information determined by a PRID to be "required model information" does not have to be made public "**until or unless** an insurer subsequently submits a complete rate application to the Commissioner that relies upon the model." (**Proposed Section 2648.5(d)**, emphasis added.) Such a blanket sealing of the administrative record violates Section 1861.07's requirement that all information submitted to the Commissioner pursuant to Prop 103 shall be made publicly available.

As a result, any members of the public, including consumers, lawmakers, and journalists, who were not a party to the PRID proceeding will be barred from accessing any documents, data, legal filings, or other information presented.

The updated draft regulations are now even more unfavorable to public participation than before, reflecting insurance industry demands. The March 14, 2024 draft regulation text required parties in a PRID procedure to agree on a stipulated NDA. Setting aside that requiring an NDA conflicts with the law, that version required CDI/insurers/modelers to work with consumer participants on an NDA agreeable to all parties. The updated regulation now allows insurance companies and private modeling firms to refuse to agree on an NDA and instead individually propose the terms of protective orders to the Model Advisor. Given the information gap between consumer participants and modelers/insurers about the model itself, this incentivizes industry participants to refuse to work with consumer participants on an agreeable NDA, with confidence that the Model Advisor will ultimately defer to the modeler/insurer/CDI itself.

The confidential PRID procedure will prevent the public from understanding how technology determines what they pay for insurance.

Polling by the Pew Research Center finds the public has enormous concerns about the fairness and acceptability of using algorithms to make decisions with important real-world consequences.[13] Across the economy, decisions by algorithms and artificial intelligence are creating disadvantage and inequities in Americans' financial lives. The public has a right to understand what's impacting decisions about their futures, but the protective orders mandated by this draft will make certain those decisions will be opaque and the insurance industry unaccountable.

Some of the many issues raised by the proposed regulation's reliance on secrecy include:

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[13] Aaron Smith, "Public Attitudes Toward Computer Algorithms," *Pew Research Center: Internet, Science & Tech*, Nov. 16, 2018, www.pewresearch.org/internet/2018/11/16/public-attitudes-toward-computer-algorithms.

- If a public interest organization learns of a key flaw in a model during a PRID procedure, but that information is held secret as part of the PRID, the organization would be unable to use that knowledge during the rate review process when an insurance company seeks to use the model. Because the protective orders prevent public interest organizations from using the information they obtain to challenge an excessive rate, or from sharing their analysis of a model with the public, public participation in a PRID is meaningless and rate review will be severely restricted.
- The proposed regulation specifically bars sharing of information *within* an organization. It would prohibit an attorney for an organization that is a participant in a PRID from reporting back to their organization's president about the proceedings; prevent a participating reporter from reporting back to their editor; and prevent a legislative staffer from reporting back to their boss.
- An organization will be barred from publicly discussing its views based on information kept secret by the protective order. A restriction common to protective orders in legal matters is prohibiting any person to discuss its terms, and corporate defendants are permitted to sue anyone they say has violated an NDA or protective order, which would be punishable by fines. Can a list of the data deemed confidential be shared? A description of that data? A critique of the confidentiality decision?
- This hypothetical scenario illustrates how an NDA or protective order will keep critical information about a model inaccessible during public rate review:

  > A key question about a model's impact on rates concerns the relative weight for each input variable (risk factor) in the model. These weights result from analyses performed within the model based on a dataset used to calibrate the model's initial parameters ("training data"). Depending on a model's construction, small changes to the weights can become highly leveraged, resulting in substantial variability in the model's output. Consumers and their advocates have a legal right to know which risk factors are being used to calculate insurance premiums. They also need to be able to understand the sensitivity of a model's results to changes in risk factor values and their relative weights. Yet detail about how a model weights different factors is exactly the kind of information companies protecting a proprietary model are likely to claim is proprietary and the Model Advisor will likely deem confidential and not required to be publicly disclosed, because it is the kind of information competitors could use to try copying their model.

The proposed regulation also does not set out any baseline requirements about what must be disclosed about every model. This means that the concealed and public data will be different for every model based on how restrictive of a protective order the model's Wall Street owner is able to engineer.

II. ACCOUNTABILITY AND EFFICIENCY: The proposed regulation does not require review or approval of catastrophe models. It does not even require a PRID procedure.

The Department has suggested this proposal is intended to allow review of models, with full public participation in that process. The current text of the proposed regulation fails to achieve that goal.

The regulation splits the Department's model oversight function into three separate potential phases: first, a superficial, closed-door inquiry into the model—the "PRID"; second, a mini-proceeding—also with no public scrutiny—during which the Commissioner will determine that an insurance company's application is "complete" (the subject of a separate complete rate application regulation the Commissioner has proposed); and third, the public rate review process required by Proposition 103, in which an insurance company would seek to rely on the secret model to justify requests to change its rates.

The first possible consideration of a proposed model would be during the newly-created "PRID" procedure. **However, a PRID may never occur.**

The ISOR repeatedly emphasizes that the "PRID procedure is voluntary," and the newly **Proposed Section 2648.5(h)(3)** specifically provides that the "owner or vendor of a model may decline to participate as a party in a PRID procedure as to that model."

Given this, why would any insurer or modeler ever volunteer to submit its model for the PRID procedure? The presumed benefit would be to prevent any model information they deem confidential from being produced during the rate application review process. However, this is not a serious threat given that the Department has consistently failed to require such disclosure in any prior rate review, even under the regulation adopted by the Department in 2022 which explicitly requires that fire risk models be made publicly available (10 CCR § 2644.9).

If a PRID does occur, its stated purpose is solely to determine what insurance companies and their modelers must disclose about a model publicly. The text of **Proposed Section 2648.5(a)(2)** states the purpose of a "Pre-application required information determination procedure," or "PRID" procedure, is to "determine all information and data regarding a model that are required to be provided to the Commissioner as part of a complete rate application that relies upon the model for purposes of requesting a proposed rate change pursuant to Insurance Code section 1861.05."

This definition is repeated in **Proposed Section 2548.5(c)**.

The new Model Advisor is charged with two main jobs: entering and enforcing the protective order, and completing the PRID. The only product of a PRID procedure is a determination about what information a modeler may keep confidential and what information an insurance company must disclose in a complete rate application.

The rest of the information produced in the PRID procedure—all the evidence collected that the Model Advisor determines is not necessary to disclose, and the arguments the parties made about disclosure—will be kept secret, preventing non-participants from ever knowing what occurred behind closed doors.

Allowing participants in the PRID to ask questions about a model is contemplated in **Proposed Section 2648.5(l)**, which refers to discovery requests, testimony, and evidence. **Proposed Section 2648.5(m)** goes as far as suggesting that parties participating in a PRID may offer expert testimony "regarding the reliability of a model." However, the ISOR makes clear that the Model Advisor would not be allowed to use such testimony to say the model is reliable. The ISOR, p. 77, states: "a PRID is not an order or decision that the model is actually reliable for ratemaking purposes." What is the point of testimony "regarding the reliability of a model" if the PRID does not determine reliability, and that testimony is not made public?

The proposed regulation gives the Model Advisor a long list of other responsibilities, but neither **Proposed Section 2648.5(l)**, **(m)**, nor any other provision charges the Model Advisor with considering that testimony, let alone making a determination about a model's reliability and safety. Nor does the regulation state that the Model Advisor has the responsibility to review a model itself, whether for accuracy, bias, or the validity of the science. The Model Advisor is not granted any authority to reject or approve a model. With no regulatory mandate for the PRID to reach a conclusion beyond what information to share, participants who represent consumers would be denied the opportunity to argue that a model should be rejected.

Indeed, specific standards by which the reliability of a model would be evaluated by the Model Advisor are absent. Basic scrutiny of a model's functionality—such as bias testing, or comparison of the model's projections to past events—is not mentioned. Nor is any comparison of models to other models contemplated—as noted below, issues with a model may not be immediately apparent unless the model is compared to similar models demonstrating drastically different outputs.

Catastrophe model inconsistency and the importance of testing.

The regulation does not define any specific rubric for evaluating or testing models. There are no guidelines for determining whether a model is reliable, accurate, unbiased, or based on the best available science and data. This omission means that even if the Department amended the proposed regulation to require model review and approval, the standards for that review could vary widely from model to model.

As former Risk Management Solutions ("RMS") Vice President of Model Development Dag Lohmann, now CEO of KatRisk, LLC, put it:

> "Multiple modelers could develop a wildfire model from all the components in current literature, tune the models to reasonably validate with historical data, and ultimately have

average annual losses ***2 or 3 times different than each other*** when projecting future losses."[14]

According to Milliman:

Model validation, as well as rigorous review of model operations and assumptions, are critical steps in assessing whether this value can be extracted from a cat model, given its intended use.[15] [Emphasis added.]

California must rigorously evaluate models if regulators, policymakers, and the public are to have confidence they are reliable.

Recent Bloomberg reporting makes clear that extreme variability in model output is a serious and persistent problem. The investigation examines evidence "that risk models often disagree with each other on fundamental assessments of vulnerability."

Bloomberg Green compared two black box models' analysis of flood risk in Los Angeles County. They found that "they clash with each other more than they agree."

"When compared only on a single, relatively simple metric, the models match just 21% of the time."

"Among the places where the Irvine model finds the highest level of flood risk are the cities of Compton and Long Beach, south of downtown Los Angeles."

"First Street, on the other hand, finds very high risk in the San Gabriel Valley and significant risk in Westside areas, including the cities of Beverly Hills and Santa Monica."[16]

Similarly, the nonprofit CarbonPlan compared the California wildfire risk predictions of two private models. While the models agreed that fire risk at 128 locations across the state would increase by approximately one-third, the two models agreed on how much that risk would increase just 12% of the time. Seven other modeling firms the organization contacted refused to provide even basic data for comparison.[17]

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[14] "Wildfire Catastrophe Models Could Spark the Changes California Needs," *Milliman*, Oct. 2019, https://www.milliman.com/en/insight/wildfire-catastrophe-models-could-spark-the-changes-california-needs.
[15] *Ibid*.
[16] Eric Roston et al., "The Risky Business of Predicting Where Climate Disaster Will Hit. Climate tech companies can tell you the odds that a flood or wildfire will ravage your home. But what if their odds are all different?" Bloomberg Green, August 9, 2024, https://www.bloomberg.com/graphics/2024-flood-fire-climate-risk-analytics/.
[17] Oriana Chegwidden et al., "Climate risk companies don't always agree," CarbonPlan, Aug. 9, 2024, https://carbonplan.org/research/climate-risk-comparison.

By setting no standards for testing, review, and approval of models, the proposed regulation leaves Californians at the mercy of widely inconsistent outcomes.

Even Florida, better known for passing industry-friendly legislation than consumer protection, requires review and approval of public and private catastrophe models.

A 2022 article examining the design and implementation of the Florida Public Hurricane Loss Model ("FPHLM") details how system evaluation is critical to ensuring the effectiveness and reliability of the model. The authors identify "multiple quantitative and qualitative evaluation methods" that are "presented to ensure the correctness, usability and robustness of FPHLM."

Comparing modeled insured losses from specific storm events with actual insured losses from claims data is the primary method of FPHLM evaluation identified. Such a test enables confirmation that actual results and model results have no statistically significant differences. It is also one way to test bias. In the tests presented in the paper, 51% of actual losses were higher than modeled losses, and 49% were lower, suggesting the model is unbiased.[18]

In addition, the authors perform a sensitivity analysis that shows how FPHLM modeled losses due to the hurricane peril vary with changes to parameters such as deductible amount, year built, number of stories, and construction type. Analyses like this of the sensitivity of loss estimates to various characteristics are critical in ensuring the equitable application of a catastrophe model's output values, as required by law. Californians must also be able to perform sensitivity analyses to evaluate any model being considered for use in rating the wildfire peril. In order to do that, unfettered access to the model itself is necessary to ascertain exactly how modeled loss amounts are impacted by user-controlled changes to input parameters.

Although the state of Florida allows the use of private catastrophe models in addition to the public model, it requires private models to be approved by an independent commission that tests the models' reliability before they are approved for use.

In 1995, the Florida Legislature created the Florida Commission on Hurricane Loss Projection Methodology. The Commission conducts on-site testing of private catastrophe models (the public FPHLM model is also tested) and is charged "with adopting findings relating to the accuracy or reliability of particular methods, principles, standards, models, or output ranges used to project hurricane losses, flood losses, and probable maximum loss calculations."

The Commission's November 2023 report on activities contains **174 pages of specific standards the Commission uses to determine whether a model is acceptable for use** by

[18] Yudong Tao et al., "Florida public hurricane loss model: Software system for insurance loss projection," 52 *Journal of Software: Practice & Experience* (2022), 1736–1755, https://doi.org/10.1002/spe.3086.

insurance companies in Florida.[19] These are the types of standards that must be developed in California so consumers can be confident the models are fair.

There is no evidence that the Commissioner has made any effort to investigate how other states evaluate models. Under this proposal, once model information is sanitized through a secret PRID procedure, regulators and the public will be incapable of verifying the models' science or math, and regulators and consumer representatives will be left with inconsistent outputs and uncertainties that cannot be explained. By limiting both access to the model and information about the model, the draft regulation forecloses such testing.

Other than bowing to demands for secrecy from the insurance companies and the Wall Street firms that sell them models, how will this process enable consumer representatives and the Department staff to effectively assess a model? It won't.

See also testimony submitted by consulting actuary Allan I. Schwartz on behalf of Consumer Watchdog regarding **Proposed Section 2648.5** and the Florida Commission on Hurricane Loss Projection Methodology ("FCHLPM").[20]

No standards and variable disclosures will result in ad hoc review.

The lack of specific, uniform standards for model approval, or review of a model's impact on a rate, in the proposed regulation sets up bespoke oversight in which every company's rate application will be treated differently.

One of the reasons why California consumers, homeowners, renters, and small businesses have benefitted from fair and reasonable rates under Proposition 103 is that a highly detailed set of regulations govern the ratemaking process and apply to every insurance company. The staff of the Department are obligated by law to apply those rules uniformly.

10 CCR § 2643.1 requires the Insurance Commissioner to use "a single, consistent methodology" to evaluate insurers' rates.

The California Supreme Court has confirmed that Proposition 103 requires uniform regulation of insurance companies. (*20th Century Insurance Co. v. Garamendi* (1994) 8 Cal.4th 216, 312; see also Order Adopting Proposed Decision, *In re American Healthcare Indemnity Company*, File No. PA02025379, July 24, 2003, p. 8.) Uniform rules of the road are not only a protection for consumers against unfair and arbitrary rates, they are a guarantee of efficient, fair, and equal treatment for all insurance companies, large or small.

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[19] Florida Commission on Hurricane Loss Projection Methodology, "Hurricane Standards Report of Activities as of November 1, 2023," Nov. 1, 2023, https://fchlpm.sbafla.com/media/532jql0c/2023-hurricane-roa.pdf.

[20] Comments by Allan I. Schwartz on behalf of Consumer Watchdog Regarding California Department of Insurance August 23, 2024 Proposed Regulation Text, Catastrophe Modeling and Ratemaking, REG-2023-00010, Sept. 17, 2024, submitted concurrently herewith.

The draft text does not meet these baseline legal requirements.

Proposed Section 2644.4.5, subdivisions (f)(1) and (4), for example, require an insurer to prove that the model is based on "what in the Commissioner's assessment is the best available scientific information for assessing frequency, severity, damage and loss" and "best available scientific information on risk mitigation at the property." However, the regulation is silent on exactly how the Commissioner makes that "assessment."

The Model Advisor has even less instruction, being charged simply with "determining required model information." (**Proposed Section 2648.5(f)**.) "Required model information" is defined in a vague way, to mean "all required information and data regarding a model . . . because such information and data will aid the Commissioner in determining whether the model is reliable . . . ." (**Proposed Section 2648.5(a)(4)**.) **Proposed Section 2648.5(b)** in turn states that "required model information" shall include "information that demonstrates the model uses established concepts, data, equations, and principles, as well as best available scientific information and data, insurance claims expertise, and other assumptions appropriate for the risk or peril being modeled," but there is no specific minimum set of information that every modeler would have to disclose.

The lack of comprehensive and precise definitions and standards will lead to arbitrary, discriminatory, and excessive rates.

Giving the Commissioner and the Model Advisor unbounded discretion with no published guidelines for their decisions opens the door to the "standardless, ad hoc decision-making" decried by the California Supreme Court in *20th Century*, *supra*, 8 Cal.4th at pp. 280, 312.

Even whether a PRID is valid, or must be redone, is unclear.

Proposed Section 2648.5(o) states a PRID is good for four years, but does not say whether a PRID is valid for all uses of a model—i.e., underwriting, risk segmentation, and rating—even if a PRID procedure only reviewed a model for purposes of projecting rates.

Furthermore, while **Proposed Sections 2648.5(o) and (p)** purport to invalidate a PRID when a model is "substantively updated, amended, altered, or changed . . . ," it is unclear how anyone would know a PRID should be invalidated.

There is no requirement for a modeler or other knowledgeable company to notify the Department when a previously approved model has been "substantively" changed. Without access to the model itself or any "confidential PRID information," no one—the Commissioner included—will be able to assess whether a model has been substantively changed simply by reviewing a rate application. Nor is there any apparent penalty for knowingly relying on a PRID determination for a substantively changed model.

The previous version of this regulation did not include the "substantively" limitation, which only makes it more difficult to determine when a PRID should be deemed invalid, as the regulations do not explain what a "substantive" change would be.

III. INDEPENDENT EXPERTISE: The proposed regulation does not leverage California's vast resources in academia and industry, instead giving vast authority to the Model Advisor—who is appointed by the Commissioner—with no required qualifications or experience.

Contrary to representations by the Commissioner and Department staff, including the March 14, 2024 press release promising a "new process for review of models by a panel of experts" to "evaluate the appropriateness and soundness of each model," the regulation does not require the appointment of an independent panel of scientific and other experts.

Expert panels with advisory, audit, and oversight authority operate across California government. The enacting legislation and regulations for such bodies will typically lay out the responsibilities of the body and parameters for choosing appointees, including: frequency of meetings, size of the panel, duties, qualifications of members, and specific stakeholders that must be represented—often requiring a diversity of viewpoints and expertise. The Department of Insurance's own website lists ten such panels and boards[21]—each of which has specific parameters for appointees.

The American Academy of Actuaries' discussion of the difficulties of model testing demonstrates the appropriateness of such an expert panel here:

> "While the technical documentation of the models is available to users for their general knowledge, some core assumptions are considered proprietary and are not readily accessible to users. A catastrophe model is developed by a group of scientists (meteorologist, seismologist, hydrologist, statisticians, engineers, actuaries, computer scientist, etc.) with specialized knowledge in different fields. It is not an easy task for model users to develop even a basic understanding of the model, as required by U.S. actuaries' standards of practice."[22]

Yet **Proposed Section 2648.5(f)** does not mandate such a panel. This section states only that the Model Advisor "is authorized to hire outside consultant(s) with relevant knowledge and subject matter expertise to assist in determining required model information." Consultants hired by the agency report to the Department and the Commissioner; they are not independent. Moreover, the draft regulation places no conditions on hiring of the consultants, such as a requirement that they be free of conflicts of interest. This employer/consultant relationship does

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[21] Cal. Dept. of Ins., "Commissioner Appointments," https://www.insurance.ca.gov/0500-about-us/03-appointments/index.cfm.

[22] Kay Cleary et al., "Uses of Catastrophe Model Output," American Academy of Actuaries, July 2018, p. 34, https://www.actuary.org/sites/default/files/files/publications/Catastrophe_Modeling_Monograph_07.25.2018.pdf.

not resemble the kind of diverse, interdisciplinary panel of independent experts with a wide array of engineering, computing, climate, and other scientific expertise that is necessary to assist the Department in correctly and independently understanding and evaluating a model's operation.

The proposed regulation requires that any work consultants submit to the Department and the Commissioner remain confidential unless it is included in a final PRID and is subsequently submitted in a rate application (**Proposed Section 2648.5(d)**).

In the past, when the Department has hired outside consulting firms to evaluate underwriting models used to determine eligibility for a homeowners policy based on wildfire risk, it has refused to disclose any of the information or analysis provided by those firms.

In one instance, a Consumer Watchdog petition for hearing in a proceeding on a Farmers rate application was denied by the Commissioner, based in part on an outside actuarial consulting firm's evaluation of Farmers' use of the Zesty.ai Z-FIRE underwriting model. The denial stated only that based on that outside actuarial firm's review of the model, the Department was "satisfied that the model is sufficient for the purpose in which it is intended to be used, as a secondary new business eligibility tool" and that "the Department has no concerns about its accuracy or reliability."[23] In violation of Proposition 103's transparency requirement, the Department refused access to the consulting firm's analysis of the model. [24]

Because the Model Advisor can conduct the PRID procedure by meeting behind closed doors with—or even relying entirely upon—"outside consultants" and exclude their work from disclosure, public access is negated.

Finally, nothing requires the Model Advisor to actually seek expert input, raising the concern that the Model Advisor could rely solely on the representations of an insurance or modeling company in a PRID procedure.

The Model Advisor is given unchecked power.

The proposed regulation envisions that the Model Advisor will make many technical and legal determinations. The regulations describe the Model Advisor's power as "without limitation," including to: "administer oaths; issue subpoenas; rule on motions to compel discovery; receive evidence and testimony" **(Proposed Section 2648.5(k)**). It is extremely problematic that the draft regulation sets forth no qualifications for the Model Advisor, who is effectively acting as a pseudo–administrative law judge. The Model Advisor is not required to have legal or technical training, or indeed, to have any relevant experience at all while making these determinations.

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[23] Decision Denying Petitioner's Petition for Hearing, *In the Matter of the Rate Applications of Farmers Ins. Exchange et al.*, File No. PA-2020-00006, May 11, 2021, p. 3.
[24] Cal. Dept. of Ins. letter denying Consumer Watchdog Public Records Act Request PRA-2021-00414, Sept. 10, 2021, https://consumerwatchdog.org/wp-content/uploads/2024/04/2021-09-10CDIZFire.pdf.

The Model Advisor will determine what information will be made public and will determine "whether there is a significant public interest in the non-disclosure of confidential PRID information." (**Proposed Section 2648.5(j)(2)**.)

Yet there are no specific guidelines to govern these determinations by the Model Advisor. Allowing such open-ended discretion without specific regulatory guidelines epitomizes the "standardless, ad hoc decision-making" advocated by the insurance industry and rejected by the California Supreme Court in *20th Century*, *supra*, 8 Cal.4th at p. 312.

IV. HIGHER RATES: Limited model disclosure will make determining a model's impact on rates impossible.

According to the draft regulation, the PRID will decide what information can be accessed by the public in the third phase of oversight: Prop 103 review of an insurance company's rate application.

Proposed Section 2644.4.5(f) states that in the context of a specific insurance company's rate application, "the applicant shall have the burden of demonstrating" to the Commissioner that the models used rely on the best science and meet actuarial standards. This is the only place in the regulation that explicitly states the reliability of models will be subject to evaluation during the rate review process. Even so, the ability to review a model's impact on rates at this stage will be extremely limited because the PRID procedure will restrict the information about the model that will be available to make that evaluation.

Access to the model itself, the model's weighting of different factors, any data used to build a model, and model output reports—including but not limited to size of loss distributions along with the probability associated with each event—are among the types of information certain to be foreclosed from public disclosure by the PRID. In recent years, insurance companies and modelers have refused to provide the Department or public participants access to such information regarding underwriting models in the rate review process, even though they are required by law to do so. The same will be true for catastrophe models.

This is the only place the proposed regulation contains any guidelines for what the commissioner would consider in reviewing a model's impact on rates. Unfortunately, as noted above, the guidelines are far too broad to provide any practical standards for regulators to follow.

Further, it is unclear how the Department would be able to determine if an applicant has met its burden, particularly as to **Proposed Section 2644.4.5(f)(2)**, which requires an applicant to show that its "use of its selected model(s) produces the most actuarially sound estimate of projected catastrophe losses." How does the Department plan to evaluate, based on limited "required model information," whether the use of any particular model will "produce the most actuarially sound estimate"? Surely the answer requires some sort of comparison between models or some other baseline to measure against, but the regulation provides for neither.

Unbelievably, the ISOR, p. 92, takes the position that the "use of catastrophe models is not expected to significantly change the total amount of aggregated premiums collected by the

insurance industry." The Department proffers no specific support for this absurd conclusion. The impetus behind this and other Department regulatory efforts has been pressure from insurance companies who say they must use catastrophe modeling to reflect higher future risks due to climate change than are reflected in historic data. The companies are not pushing for these changes so that they can lower their rates—they are seeking to price higher levels of catastrophe risk into their rates.

V. CONFLICTS WITH OTHER RECENT REGULATIONS: The draft regulation prioritizes the protection of trade secrets over longstanding principles of government accountability and transparency, in violation of existing law and regulations.

Wall Street modeling companies have made clear in their public statements, comments to the Department of Insurance, and testimony before the Legislature that they are unwilling to disclose their algorithms or datasets or to provide access to the actual catastrophe models.

Zesty.ai submitted testimony regarding the wildfire mitigation discount regulation stating:

> . . . the current draft regulations would jeopardize the industry's ability to protect intellectual property and thus limit new innovation from being introduced in the California insurance market. As such, we would recommend that "data, algorithms, [and] computer program" as currently detailed in subsection (f) should be excluded from the public inspection process.[25]

At the July catastrophe modeling workshop, Moody's RMS submitted a list of what it insisted it would not disclose:

> Any elements that are considered Intellectual Property
> Proprietary data sets (in-house / third party)
> Software programs
> Source Code
> Notional sensitivity analyses showing all possible combinations of output of model
> Client Specific Results[26]

The proposed catastrophe model regulation capitulates to those demands. In fact, Consumer Watchdog has repeatedly objected to the Commissioner's failure to enforce the public disclosure requirements for wildfire risk models set forth in the wildfire mitigation regulation (10 CCR § 2644.9) he adopted, and CDI has reversed course on positions it took in adopting those regulations and in amendments to the "complete rate application" regulation Commissioner Lara

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[25] "ZESTY.AI STATEMENT," *California Department of Insurance Prenotice Public Discussion on Mitigation in Rating Plans and Wildfire Risk Models*, REG-2020-00015, November 10, 2021, p. 2.
[26] "Moody's RMS Presentation," *California Department of Insurance Workshop Examining Catastrophe Modeling and Insurance*, REG-2023-00010, July 13, 2023, p. 5.

proposed earlier this year (REG-2019-00025). However, the confidentiality provisions in **Proposed Section 2648.5(a)(7)**—"confidential PRID information shall not be public information and shall be considered to be information received in official confidence by the Department of Insurance"—and the protective order provisions in **Proposed Section 2648.5(j)(2)** conflict with the public disclosure requirements of Proposition 103's Section 1861.07.

The Department made a robust case for the submission and full disclosure of models, their algorithms, and all data associated with a model in the rulemaking documents supporting the necessity of both regulations.

Proposed Sections 2648.5(a)(4) and (5), and Proposed Sections 2648.5(b) and (r), incorporating the "complete rate application" regulation (section 2648.8), directly conflict with the Department's proposed amendments to that regulation. Together, these provisions define the limited scope of the "model information" that must be provided as part of a complete rate application. Such information is not a substitute, however, for providing the "model" itself and any model "algorithm" as part of a complete rate application, as required by CDI in proposed amendments to section 2648.4 and section 2644.9 as adopted.

Proposed section 2648.4 of the "complete rate application" regulation requires that models and algorithms used to accept, reject, or rate a risk must be provided as part of a complete rate application and made publicly available. Wildfire risk models used to determine individual premiums are similarly required to be submitted to the Commissioner and publicly disclosed pursuant to section 2644.9(c) and (f) as adopted in 2022.

In proposing the "complete rate application" regulation in February, the Department explained the necessity of providing models and algorithms as part of a complete rate application as follows:

> In order to fully evaluate an insurer's request to change its rates and determine whether the requested rate change is appropriate and not excessive, inadequate, or unfairly discriminatory, the Commissioner must be able to review all information that may have a potential impact on the requested rate during the projected rating period. Relevant here, the general criteria, guidelines, systems, manuals, models and/or algorithms that an insurer uses to determine whether to accept or reject new and renewal business and to determine an applicant's or insured's coverage or coverage options may loosely be referred to as "underwriting guidelines."[27]

The Department similarly argued the necessity of disclosing models and algorithms in adopted regulation and the Final Statement of Reasons in the Mitigation in Rating Plans and Wildfire Risk Models rulemaking, REG-2020-00015. Subdivision 2644.9(f) of that adopted regulation states that any "Wildfire Risk Model," and "any records, data, algorithms, computer programs, or any other information used in connection with the rating plan or Wildfire Risk Model used by the insurer" shall be available for public inspection. In responding to public comments in that rulemaking proceeding, the Department explained, in no uncertain terms, that

[27] Cal. Dept. of Ins. Initial Statement of Reasons, REG 2019-00025, Feb. 9, 2024, p. 15.

section 2644.9(f) requires all Wildfire Risk Models used in support of a rate application to be publicly filed:

> The commenter wants to modify text of proposed section 2644.9(c) . . . ***instead of requiring the insurer to file publicly the model*.**
>
> The Department responds that in order for the Commissioner to determine whether an insurer's rates are excessive, inadequate, or unfairly discriminatory, insurers ***must provide as part of a complete rate application any rating plan or Wildfire Risk Model that segments rates, creates a risk differential, or surcharges premium***. Any such information regarding the Actuarial Standards of Practice (ASOPs) or the scientific basis underlying a Wildfire Risk Model provided to the Commissioner would be ***in support of the requirement that the Wildfire Risk Model itself be provided as part of the insurer's complete rate application***. Without this information, the Department is not able to review an insurer's rates for compliance with Proposition 103, in particular the requirement in Insurance Code section 1861.05(a) that an insurer's rates not be excessive, inadequate, or unfairly discriminatory. ***The Department has determined that it is necessary for a Wildfire Risk Model, if used to segment rates, create a risk differential, or surcharge the premium, to be submitted to the Commissioner as part of an insurer's complete rate application***."[28]

The proposed regulation appears to empower the Model Advisor to override these requirements through the PRID procedure, which would conflict with both regulations and Insurance Code section 1861.07.

VI: LIMITING GOVERNMENT ACCOUNTABILITY: The proposed draft seeks to exclude model review from the protections of the California Administrative Procedures Act and Proposition 103 that are required in rate hearing.

Proposed Section 2648.5(a)(1) and (2) refer to the "Pre-application required information determination" and "procedure" (the PRID) as "nonadjudicative." To the extent the Department is seeking to exempt review of models used in determining rates, premiums, and underwriting from the longstanding protections against government overreach set forth in the California Administrative Procedures Act (APA), which applies to all "adjudicative proceedings," it should reverse course.

The Administrative Procedures Act provides baseline procedural protections through its "Bill of Rights," found in Articles Six through Eight of the APA (Gov. Code §§ 11425.10–11435.65). Among the most important of those rights are that (1) hearings must be open for public observation; (2) the adjudicative function must be separated from investigative and advocacy functions; (3) presiding officers are subject to disqualification for bias; (4) decisions must be based on the record; and (5) ex parte communications are restricted. (Gov. Code § 11425.10.)

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[28] *Comments Received and Department Responses,* REG-2020-00015, pp. 274–75, emphasis added.

Moreover, the proposed PRID procedure would permit the Model Advisor to conduct the entire procedure behind closed doors without any public participation. **Proposed Section 2651.10(e)** gives the Model Advisor "discretion to grant or deny a request to initiate or intervene in a PRID procedure." (Emphasis added.) This conflicts directly with Proposition 103, which provides California consumers with an *unqualified* right to initiate or intervene in any proceeding permitted or established pursuant to chapter 9 of Part 2 of Division 1 of the Insurance Code.[29]

Section 1861.10(a) states:

> Any person may initiate or intervene in any proceeding permitted or established pursuant to this chapter, challenge any action of the commissioner under this article, and enforce any provision of this article.

Even if the Model Advisor chooses to permit such participation, as discussed above, the regulation purports to make the entire PRID procedure confidential, including any hearings. (**Proposed Section 2648.5(a)(7)**.) No provisions prevent the Model Advisor from engaging in ex parte communications, or require the separation of decision-making and advocacy functions. Additionally, nothing in the regulations specifies that the Model Advisor must state the factual basis of their decision based exclusively on evidence in the record when determining what model information must be provided. The APA should explicitly apply to any model review. The APA will ensure minimum protections are in place to help rectify these issues by requiring public observation, limiting ex parte communications, requiring separation of functions, and requiring the ultimate decision be based on facts in the record.

VII. ERECTING ADDITIONAL BARRIERS TO PUBLIC PARTICIPATION—OR A PRID HAPPENING AT ALL.

Responding to insurance industry comments, **Proposed Section 2648.5(h)** of the August 16, 2024 proposed text erects additional barriers to deter and diminish the public's ability to participate meaningfully, or indeed, to initiate a PRID procedure in the first place.

The updated regulation erects three new hurdles in order for a petition to initiate a PRID procedure to be granted.

First, the Model Advisor must determine that "the petitioner has demonstrated it is more likely than not that the Commissioner would benefit from a PRID." This is a vague and subjective standard with no further elaboration. The ISOR states the purpose of this subdivision is "to allow for broad public participation" in the PRID process and "to encourage public review of models at the outset" (ISOR, pp. 79–80). As drafted, this provision instead gives the Model Advisor nearly unbounded discretion to deny petitions to initiate a PRID procedure and block public participation before it begins.

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[29] The ISOR at p. 29 cites the following sections of the Insurance Code as authority for adopting the proposed regulations: Sections 1850.4, 1858.6, 1861.01, 1861.05, 1861.07, 1861.09, 1861.10. All of these sections are contained within Chapter 9 of Part 2 of Division 1 of the Insurance Code.

Second, the Model Advisor must find that "the model has not been previously been [sic] subject to public review in any other forum in California, including without limitation as part of a complete rate application, within the prior four years." The regulation does not explain when a model would be considered to have "been subject to public review in any other forum." However, taking the regulation and the ISOR commentary together, it appears the Department's position is that models that have been previously used in a rate application that has been approved in the last four years will not be subject to a PRID procedure, which is highly problematic.

It is unclear what "public review" in proposed subdivision (h)(1) means. The ISOR, p. 80, states this provision was added to address concerns following prior public workshops "about models that have already been subject to extensive public review having to be re-reviewed through the PRID procedure if any person can petition to initiate at any time." Consumer Watchdog knows from experience, however, that the Department has not been subjecting models to "extensive public review" in the rate review process, and nothing in the proposed regulation requires any such "extensive public review." Indeed, the Department has not been requiring insurers to publicly provide models or extensive information about their inner workings, in deference to the complaints of modelers and insurers over disclosing allegedly confidential information, and the proposed regulation enshrines this practice. Moreover, nothing in the proposed regulation specifies how the public would be informed of which models have been previously subject to "extensive public review" and would thus be exempted from a PRID procedure.

The ISOR, p. 80, further states: "The PRID procedure is not intended to invalidate previously approved models." However, the Department has previously taken the position that it doesn't "approve" models, so it is unclear how this new provision (h)(1) would be interpreted and applied to models used in past approved rate filings. Moreover, it is unclear whether "any other forum" includes forums outside the Department of Insurance. If so, this would be highly problematic as other jurisdictions are not subject to Proposition 103's prior approval and public disclosure requirements.

Finally, once a PRID petition is granted, newly **Proposed Section 2648.5(j)(1)** purports to require parties in a PRID procedure to state how they will "avoid duplication" with no further direction. It is entirely unclear how this provision will work in practice, particularly given that parties will know nothing about the model under consideration before the proceeding begins.

The proposed regulation makes it more difficult for participants to demonstrate a substantial contribution.

Proposition 103 enables consumer participation in insurance oversight by requiring compensation for consumers and organizations that represent consumers, creating a level playing field with the insurance—and in this case modeling—industries. Under the prior version of the proposed regulation, whether a participant in a PRID procedure made a "substantial contribution" for purposes of being entitled to compensation was assessed under the definition contained in section 2661.1(k) that has been applicable to every other request for compensation in proceedings before the Department for nearly 20 years.

Newly **Proposed Section 2648.5(h)(4)(A)** conflicts with Insurance Code section 1861.10(b) and purports to significantly restrict the definition of "substantial contribution." This appears to be a clear effort to disincentivize rather than encourage public participation, which courts have held is the key purpose underlying the Insurance Code section 1861.10(b). (See, e.g., *Econ. Empowerment Found. v. Quackenbush* (1997) 57 Cal.App.4th 677, 686 [the purpose of intervenor fees is to encourage consumer participation].)

Under the "substantial contribution" standard in Insurance Code section 1861.10(a), a party's entitlement to fees "requires a significant, distinct contribution, but not more" (*State Farm General Insurance Company v. Lara* (2021) 71 Cal.App.5th 197, 214). **Proposed Section 2648.5(h)(4)(A)** creates an additional requirement that a participant demonstrate that "as a result of its participation, the Model Advisor ***has included in the PRID*** additional information or data regarding the model that would not otherwise have been identified." (Emphasis added.)

This narrowed definition is particularly problematic in the context of a procedure that is effectively entirely confidential. By definition, a PRID will not <u>include</u> any information or data that is not found to be "required model information." This means that if a participant's involvement led to a wealth of information being provided that would not otherwise have been available for the Model Advisor to make their ultimate determination, but that information is not deemed "required model information," the participant could not show a substantial contribution, even if the additional information was highly relevant.

Additionally, **Proposed Section 2648.5(h)(4)(C)** directly conflicts with Section 1861.10(b)'s requirement that: "The commissioner or a court *shall* award reasonable advocacy and witness fees and expenses to any person who demonstrates that he or she has made a substantial contribution . . . ." However, **Proposed Section 2648.5(h)(4)(C)** states the commissioner may deny fees to two parties if: "the substantial contribution claimed by a participant duplicates the substantial contribution of another party . . . ." This provision purports to allow the Commissioner to deny fees to a party that the provision itself acknowledges made a "substantial contribution." The Commissioner lacks discretion under Section 1861.10(b) to deny fees to parties that he acknowledges made a substantial contribution.

VIII. ALLOWS MODELS FOR AUTO AND OTHER FORMS OF INSURANCE. The regulation goes beyond wildfires to grant the commissioner broad, unrestrained authority to approve models for other purposes.

Proposed Section 2644.4.5(c)(1)–(3) allows the commissioner to expand the use of catastrophe models to "<u>additional lines or exposures</u>" and determine not only the catastrophe load, but project average annual losses in any line "<u>at the Commissioner's discretion</u>."

This rulemaking was convened in response to the shortages in the home insurance marketplace and insurance companies' insistence that they can't do business in California unless they are allowed to use catastrophe models to predict wildfire risk. It is easy to imagine the potential for abuse if the Commissioner starts receiving requests from insurance companies to expand their use of catastrophe models to predict losses in any line, as will surely occur. This

expansion would be a dramatic and unnecessary change when models can be inaccurate and inconsistent and contain biases.

As noted above, 10 CCR § 2643.1 requires the Insurance Commissioner to use "a single, consistent methodology" to evaluate insurers' rates and the California Supreme Court said open-ended discretion without guidelines opens the door to "standardless, ad hoc decision-making."

To allow insurers to use models in any line to project average aggregate non-cat losses in place of insurer-specific data and specified trend periods and making that determination a discretionary one will lead to the very inconsistency in application of the regulatory formula across insurers that 10 CCR § 2643.1 prohibits.

Also see testimony of consulting actuary Allan I. Schwartz submitted on behalf of Consumer Watchdog regarding **Proposed Sections 2644.4.5** and **2644.5**.

IX. PAST TESTIMONY

We incorporate and submit here our previous comments of July and September 2023 and April and June 2024 that contain further resources and examples of why thorough, transparent review of models and their impact on rates is so necessary.[30]

See these comments for additional information on:

- Models' inconsistency. For example:

> At the Virtual Meeting Regarding Home Hardening and Wildfire Catastrophe Modeling held by the California Department of Insurance on December 10, 2020, Allan I. Schwartz, Fellow of the Casualty Actuarial Society and a Member of the American Academy of Actuaries, presented testimony to illustrate how this variability manifests in the private earthquake models already in use in California.

[30] Consumer Watchdog testimony, "California Department of Insurance Workshop Examining Catastrophe Modeling and Insurance," REG-2023-00010, July 12, 2023, https://consumerwatchdog.org/wp-content/uploads/2023/07/Consumer-Watchdog-Testimony-Catastrophe-Modeling-Workshop-7-13-23.pdf; Consumer Watchdog testimony, "California Department of Insurance Workshop Examining Catastrophe Modeling and Insurance," REG-2023-00010, Sept. 28, 2023, https://consumerwatchdog.org/wp-content/uploads/2023/09/Consumer-Watchdog-Testimony-9-28-2023-2nd-CDI-Catastrophe-Modeling-Workshop.pdf; Consumer Watchdog testimony, "California Department of Insurance Workshop Examining Catastrophe Modeling and Insurance," REG-2023-00010, April 23, 2024, https://consumerwatchdog.org/wp-content/uploads/2024/04/Consumer-Watchdog-Testimony-Catastrophe-Modeling-Workshop-04-23-24.pdf; Consumer Watchdog testimony, "Fourth Workshop Regarding Catastrophe Modeling and Ratemaking: Insurer Commitments to Increase Writing of Policies in High-Risk Wildfire Areas," REG-2023-00010, June 26, 2024, https://consumerwatchdog.org/wp-content/uploads/2024/06/2024-06-27-Consumer-Watchdog-Comments-6-26-24-Workshop.pdf.

He identified examples of dramatic differences in the results of the models consulted by insurance companies.

- The academic scrutiny of flaws in financial industry climate prediction software. For example:

  Boston School of Law Professor Madison Condon presented a public interest critique including: the modeling firms' conflicts of interest; the disproportionate impact of data bias on communities of color; and how the secrecy of private models hides errors.

- Detailed questions about a model's function and impact that reviewers require access to a model to answer. For example:

  How is risk scoring determined for quantitative variables that have multiple components (e.g., Fire station proximity: Physical distance, staffing, average drive duration, complications in an active wildfire scenario, etc.)?

  How are elements that fluctuate quickly but have a significant impact on model output—such as demand surge, inflation, and construction and labor costs—treated in the model?

- The lack of a California investigatory record concerning models' accuracy and reliability in other states, and the lack of analysis projecting models' impact on rates in California.

- Algorithmic bias and discrimination in other aspects of consumers' financial lives, such as higher mortgage interest rates charged to Black and Latino borrowers than white borrowers.

- The Wall Street and insurance industry ties creating financial conflicts of interest at some of the largest modeling firms.

CONCLUSION

Responsible use of catastrophe models in compliance with California's rate oversight and transparency requirements requires that models be publicly reviewed for accuracy, reliability, and bias, and be approved for use. Full access to a model and the ability to test its results are a prerequisite for the public and regulators to be able to determine if its predictions and impact on consumers' rates are fair and justified. We urge the Department to redraft the proposal with these standards in mind.

A public California Wildfire Catastrophe Model would best meet these fairness and accountability goals, and empower consumers, communities, and the state to incentivize risk reduction and more transparently predict climate risk.