Smoke & Mirrors Episode 3

Speaker 9
(0:00) The Palisades fire and the Eaton fire have combined for 38,600 acres in Los Angeles County. (0:09) Wildfires have killed at least 24 people in the greater Los Angeles area, destroying entire communities and more than 12,300 structures. (0:17) More than 37,000 insurance claims have been filed so far. (0:21) By one estimate, at least two-thirds of homeowners are underinsured.

Speaker 10
(0:25) Insurance companies manipulated their reports to pay homeowners less money or deny their claims altogether. (0:31) Software used by many insurance companies is leaving some homeowners without sufficient coverage. (0:37) People who had 360 value estimates were underinsured by 40% or more.

Speaker 11
(0:42) I feel like I did all the right things. (0:44) I had the insurance, paid the premiums, I got the most I could get, and I've learned that I didn't have nearly enough coverage. (0:52) So now I don't know what I'm going to do.

Speaker 5
(0:53) A few months before the fire and I told him that I wanted the house to be insured to the max because I wanted to be able to sleep at night. (1:04) All I got was a declarations page saying that the 800, mid-800s would adequately cover me in case of total loss. (1:16) And so we just believed him.

Speaker 1
(1:19) The person's voice you are hearing is Colorado resident Barbara Holob. (1:24) She's talking about her State Farm insurance adjuster, who maintained that her home was properly insured, somewhere in the mid-$800,000 range. (1:32) But then came the Marshall Fire in 2021, and unfortunately the couple lost their home. (1:37) And as they feared, they didn't have enough coverage. (1:40) State Farm and other insurance companies use a program called 360Value, which scrapes data of property records and construction costs to determine policy limits. (1:50) Turns out many policies are underinsured in the first place because of this software. (1:56) When it came time to determine rebuild costs, Barbara was given a report by a company named Xactimate. (2:02) But it was short of the quote to rebuild from her contractor by about a million dollars. (2:07) Instead of getting traditional construction bids, insurance companies use programs like Xactimate that utilize data, algorithms, and artificial intelligence to determine rebuild costs.
(2:18) Turned out State Farm wouldn't pay her more than her policy's coverage limit. (2:21) Worse, trying to understand her Xactimate report, which details costs to rebuild a home, was like trying to decode a language no one uses. (2:29) It was hundreds of pages of numbers and words.

Speaker 5
(2:31) My husband, Kirk, and I have done a lot of DIY projects, so we're familiar with construction.(2:38) We had no idea what this Xactimate was telling us. (2:42) And so I would say to the adjuster, well, where are the electrical outlets?
(2:48) Oh, they're included in the square footage. (2:51) Where are cabinets and light fixtures?(2:54) Oh, they're included in the fixtures.
(2:55) And where are the labor rates? (2:57) How do I know the labor rates are for our area? (3:00) Oh, we just choose something that's appropriate for the area.
(3:03) But they don't tell you that in a real easy way. (3:06) They spend like five minutes. (3:08) When they're done with the explanation, you're like, what did they just say?

Speaker 1
(3:11) Through one-size-fits-all methods of determining coverage limits and rebuild costs, Barbara was underinsured and didn't get enough money back to rebuild her home. (3:19) Both the software that shapes policy limits, 360Value, and the software that determines rebuild costs, Xactimate, are owned by one big tech company, Verisk. (3:29) So how do companies like Verisk shape our property insurance?
(3:33) In this episode, we will examine how technology has increasingly taken over every aspect of our home insurance policies, from the algorithm that decides how much insurance we need when we sign up, to the algorithm that determines what it will cost to rebuild after a disaster, to the ones that set your fire risk score and decide how much companies get to charge for future disasters. (3:55) The data that feeds this technology is often incorrect and always hidden from public view. (4:01) I'm Justin Klosko.

(4:03) This is Smoke and Mirrors, a new investigative podcast series from Consumer Watchdog.(4:08) And this is Episode 3, How Tech and Data Shape Property Insurance. (4:17) William May also is having issues with insurance.
(4:20) A resident of the Pacific Palisades in California, May lost his home in the Palisades Fire.(4:25) A state pharma adjuster said the insurance giant would pay out around $1.7 million. (4:30) That's the amount they insured the home for in 2018.
(4:33) Today, his coverage limit is $3.4 million.

Speaker 6
(4:35) And I said, it's got to be worth more now. (4:38) I didn't realize what a pot of you-know-what I was stepping into because sometime later, he got overruled. (4:45) It got knocked down to $1.35, which is $250 a square foot for a 4,300 square foot, two-story house with all the niceties of houses in our area now. (4:57) So that was very disappointing. (5:00) I told them a million times, this is ridiculous for it to be worth less now than it was when it was new. (5:06) And how can it be worth less now when you haven't even seen the property?
(5:09) Because the property is gone.

Speaker 1
(5:11) Turns out State Farm used Xactimate for Bill May's home to decide how much to rebuild.(5:15) But the actual cost to rebuild his home is also about a million more than what State Farm wants to pay for. (5:20) May isn't waiting around for insurance.
(5:23) He's on his way to rebuilding. (5:24) But so far is out of pocket about a half a million dollars.(5:27) It all starts with underinsurance.
(5:29) Barbara and Bill aren't the only ones who aren't getting the payments they deserve. (5:33) And this is according to studies conducted on insurance payouts in the wake of extreme weather disasters. (5:38) Nearly 75% of people who filed the claim following the Marshall Fire were underinsured.
(5:43) That's according to a research paper done by the University of Colorado at Boulder and the University of Wisconsin-Madison. (5:48) The study compared the actual cost to rebuild versus the coverage policyholders had. (5:53) So why were they underinsured?
(5:55) It wasn't because they couldn't afford enough insurance or because of where they lived or even increasing rebuilding costs, as Philip Mulder, a professor of risk and insurance at the University of Madison-Wisconsin and co-author of the study explains.

Speaker 3
(6:09) Even very relatively affluent people in like in this part of Boulder, most of the households are actually pretty well off. (6:15) Even these relatively affluent people were still mostly underinsured.(6:19) We kind of think that, and this is sort of based on a lot of other evidence, is that people are given these replacement cost estimates when they get their policy quotes, and that very often customers more or less trust those quotes.
(6:31) So the evidence we see for this is that actually kind of the biggest driver of how underinsured you were was which insurer you chose. (6:38) And it doesn't seem like this is related to anything about the policyholders. (6:42) If you were with an insurer who tends to rate less coverage, you were slower to rebuild.
(6:46) You were more likely to move away instead of rebuilding.

Speaker 1
(6:49) Their study looked at 14 insurers making up about 85% of the market. (6:54) And in California, it's the same thing. (6:56) A California Western School of Law professor analyzed about 60,000 California claims from the past four years, and he found 9,000 lost their homes.
(7:04) And about two-thirds of those who lost their homes were underinsured. (7:08) In addition to shaping how policies are formed and paid out, Verisk is also one of the world's largest companies using modeling to determine overall risk from wildfires, hurricanes, and floods, which insurance companies also use to raise premiums. (7:26) It's not the only such company, but it has more market share, and competing data and analytics companies don't do all the things that Verisk does.

Speaker 13
(7:34) Customers are pretty blown away by the technology. (7:37) They think it's pretty cool.

Speaker 1
(7:38) That's from an Xactimate marketing video. (7:40) If you're actually a customer who thinks this stuff is pretty cool, please get in touch with us so we can verify that you exist. (7:47) Thank you.
(7:48) Let's go back and start this origin story in the 1970s. (7:57) Insurance companies wanted statistical data, so they created a nonprofit to collect it. (8:03) Remember, this was pre-internet, so data wasn't easy to get.

Speaker 2
(8:06) And the leader of that effort was the Insurance Services Office. (8:11) It was a nonprofit organization at the time, and it specialized in collecting information about motorists and homeowners and everybody else, claims, it proposed rates, it circulated proposed premiums to all the insurance companies across the country, which would normally be an outright violation of the antitrust laws, because it's monopolistic, it's anti-competitive.

Speaker 1
(8:35) That's Harvey Rosenfield, who founded our organization, Consumer Watchdog, about 35 years ago and spearheaded Proposition 103, the law that leveled the playing field against insurance companies in California. (8:47) More on that later. (8:48) ISO came up with standardized policy forms, ratings, loss data, modeling, and risk analytics.
(8:54) This organization would become elemental to the rise and success of the insurance industry. (8:58) It made insurance companies bigger, better, faster, stronger. (9:01) More policies were sold, and companies took over more market share.
(9:06) Okay, let's jump to the 90s. (9:13) In comes McKinsey, that big corporate consultant. (9:17) All the big insurance companies worked with McKinsey to imagine a new way to approach claims, and what McKinsey advised was to incorporate new technology to lower risk and increase profits.
(9:28) Perhaps in part to avoid antitrust scrutiny of price fixing, ISO reorganized as a corporation.(9:34) In the early 2000s, it then acquired ExactAware and created 360 Value, then officially became Verisk, the global analytics powerhouse it's known as today. (9:45) Its goals?
(9:45) Here's what Verisk said in an SEC filing. (9:48) We enable risk-bearing businesses to better understand and manage their risks. (9:53) Our decision analytics solutions facilitate the profitable underwriting of policies. (9:58) We encourage our customers to share more data with us to enhance the power of our analytics so that our customers can profit from improved risk management decisions.

Speaker 2
(10:08) They claim they want to be able to price better, but it just happens to work out that the insurance industry finds a way to charge people too much money.

Speaker 1
(10:16) In its quest to dominate the market, Verisk ran into legal troubles. (10:20) A jury in New Jersey ordered Verisk to pay $125 million to a smaller competitor over allegations that Verisk stole patented rooftop imagery. (10:28) The companies eventually settled the case, and an antitrust lawsuit filed against State Farm and Verisk argued that through predatory pricing meant to undercut competition, Verisk allows insurance companies to shave off a few dollars off of how much each home is insured in order to monopolize the market.
(10:44) And at the same time, homeowners lose hundreds of thousands of dollars. (10:47) A judge dismissed that case, though, ruling that it wasn't an antitrust claim, but instead a matter of how technology was used. (10:53) And so what kind of data does Verisk collect, and where does the data come from?
(10:57) Here's attorney Thomas Lozier, a former federal cyber tech prosecutor who now works in private practice at the civil litigation firm Cachette Petrie McCarthy. (11:06) He's suing Verisk right now in connection with the car industry.

Speaker 8
(11:09) A company like Verisk gets data from many other places, including buying it from online data brokers whose origin they may or may not know. (11:18) I mean, the fact of the matter is there are terabytes of data about individuals out there on both the commercial market and in a gray market, or even on the dark web. (11:28) And there are many data consolidators who will buy that data from all of those sources and repackage it.

Speaker 1
(11:35) Now, that's scary. (11:36) But it's not just the data. (11:38) It's also the stuff that is missing in the data that's a problem.
(11:41) Data often is incorrect. (11:43) That's because Verisk auto-compiles what it finds on the internet from municipal property records. (11:48) But if that data is missing, the program just puts something else in that it thinks is comparable.
(11:53) So a lot of its data about homes is outdated, for example. (11:57) Here's Philip Mulder again.

Speaker 3

(11:58) What you hear in statements from the company and around investigations that have happened before is that makers of these softwares are clear that, you know, these are not like plug-and-play tools. (12:07) You need to account for very detailed characteristics of the home.(12:12) And if you don't, you're likely to underinsure.

Speaker 1
(12:14) 360 value and Xactimate are both black box database tools. (12:18) So first people become underinsured and then they get underpaid. (12:21) According to court and government documents and lawsuits against Farmers, State Farm, and USAA, 360 values data set was often incomplete or outdated and often never verified by agents.
(12:32) But insurance companies still used it to establish policies for people. (12:36) With Farmers, for example, this pre-filled data included the size of homes, quality and age, foundation shape.(12:42) It's a one-size-fits-all approach.
(12:44) But it went even further. (12:45) According to court records, agents manipulated the program to lower home grades, maybe in order to offer a price that is too low. (12:51) Mulder thinks this may have something to do with how agents selling policies are trained, to move fast and quote customers low prices.
(12:58) If they quote higher, more realistic prices, they might risk losing customers. (13:02) Bottom line, it doesn't make money.

Speaker 3
(13:05) If you're an agent trying to make a sale, you can take more time, meaning you have less time to do more business, to quote people higher prices, which means you're less likely to make the sale. (13:14) Or you can quote them a low attractive price quickly, which increases your chances of making a sale, lets you make more sales.

Speaker 1
(13:20) So that could help shed some light on why Barbara Holob and Bill May are where they are today. (13:26) And even though construction costs may be higher, that's not the excuse for being underinsured, according to the study we talked about.

Speaker 12
(13:32) So basically, like you're saying, it's not really rebuilding costs or the age of the policy that's driving this stuff from what you guys found.

Speaker 3
(13:39) Yeah, that's right. (13:40) So another, I think, really important detail to understand with these policies is this whole practice of like extended replacement cost coverage and an inflation guard. (13:48) Going into the paper, I think we had a strong belief that part of the problem here was going to be that folks were not updating their coverage year to year, right?
(13:58) That you get some coverage limit and then you stick with it. (14:00) What's really cool about this data is we can see the coverage the first year you got your contract and what is today.(14:04) They've all gone up.
(14:05) And when you take a look at your own homeowner's insurance policy, it's this inflation guard thing, or it's called different things, but it's a very standard part of homeowner's policies these days. (14:13) And so the average extended replacement cost policy sort of covered that.(14:17) The problem is that the Cover J limits were too low in the first place.

Speaker 1
(14:20) Sounds like Barbara Holop's story. (14:21) She too had an inflation guard. (14:23) Cover J is the main part of the insurance policy, the amount that insures the home.
(14:27) This shows how both various programs work in tandem to underinsure. (14:31) But what's interesting on the rebuild side is that policyholders are using Xactimate as well and getting wildly different results compared to insurance companies. (14:40) Barbara summed it up this way.

Speaker 5
(14:41) Garbage in, garbage out.
Speaker 1
(14:42) After State Farm delayed Barbara's payment by almost a year, the couple retained a lawyer who told her to use her own Xactimate. (14:49) She couldn't make heads or tails of the technology still. (14:52) The program is so hard to use and understand that they had to pay $6,000 out of pocket just to hire someone who knew how to use it.

(14:58) They used it twice. (15:00) One time it valued their home at $2.1 million and the other time at $1.9 million, still twice as much as what State Farm valued it as. (15:08) So it seems like an insurance company problem.

Speaker 5
(15:11) We'd say, well, we had this kind of countertop. (15:14) Well, we don't have that kind of countertop in our database, so we have to substitute something. (15:19) So it feels like you have to choose something that's of lesser value than what you had or you're lying by saying it's of greater value than what we had.
(15:28) So nothing really matched.

Speaker 1
(15:30) To give you a sense of how unexact Xactimate is, Barbara installed a 5x7 steam room shower with a nice radiant bench heating. (15:38) Parts from Germany.

Speaker 5
(15:39) It was finished like a couple days before the fire. (15:42) We never got to use it even once.(15:44) All the stuff that we had in that steam room shower was not in their database, and he could not substitute anything else.

Speaker 1
(15:55) Still, Barbara said she used her own Xactimate reports as leverage to get paid by State Farm. (16:02) But Verisk has control of another part of the insurance galaxy, and that's something called catastrophic risk modeling, or CAT modeling. (16:09) Before the current insurance commissioner in California, Ricardo Lara, insurers in the state could use models only to sort or group customers, but not to calculate the rates themselves. (16:21) Now these models can be used to estimate the portion of rates related to disaster risks like wildfires. (16:26) You know, this isn't necessarily bad, but there's a big concern. (16:30) They're completely secret.
(16:31) The Department of Insurance process to quote-unquote review these models keeps all their inner working secret. (16:37) No one really knows how accurate they'll be at predicting future losses.

Speaker 4
(16:41) My name is Ben Armstrong, and I'm the staff actuary for Consumer Watchdog.

Speaker 1
(16:47) Part of Ben's job is to look under the hood of an insurance company's rate filing. (16:51) It's complicated stuff, and we're glad he's on our team.

Speaker 4
(16:55) My background is I have a bachelor's in actuarial science from the University of Nebraska-Lincoln, which is an accredited center of actuarial excellence. (17:04) I spent 11 years working as an actuary for an insurer.

Speaker 1
(17:08) Mercury Insurance, using Verisk's tech, is the first company to file a homeowner's rate increase under the regulations, which enable insurers to use models for catastrophes that impact rate-making for the first time. (17:20) One of the things Ben looked at was Mercury's proposed 6.9% rate increase. (17:25) Why 6.9%? (17:26) Because at 7%, consumers are allowed to demand a public hearing before it's approved by the California Department of Insurance.

Speaker 4
(17:33) You've just got to ask the question, how do we know which one of these is correct, and how can we be confident that insurers using these models are not overcharging their customers?

Speaker 1
(17:44) Ben analyzed Mercury's proposed rate increase, which used Verisk's catastrophic model, but he couldn't verify the portion of the rate that Verisk's model was used for. (17:53) In fact, the process set up to review models is intentionally made secret. (17:56) Ben can't tell, no actuary can, just from Mercury's application whether the output from the models is fair and equitable and results in rates that are not excessive, inadequate, or unfairly discriminatory, which is a key tenet of actuarial rate-making.
Speaker 4

(18:11) Now, if we just want to talk strictly about the Mercury Cal Auto filing, I can tell you that if they had to use the catastrophe framework that was in place prior to these new regulations, they would not qualify for a rate increase at all.

Speaker 1
(18:27) So what Ben is saying is that the homeowners' rate filings under the new regs may appear to support rate increases that are significantly higher due solely to the use of the CAP models.

Speaker 4
(18:37) It's not clear to anyone outside of the organizations that developed these models how accurate that is. (18:46) And compounding the issue is the fact that it's a well-known facet of catastrophe models that you can line up three different reviewed, well-respected catastrophe models, feed them the same data, and get wildly different results out of it.

Speaker 1
(19:00) So if Insurance Commissioner Laro's rules stand, we will never see inside the black box to tell how accurate these models are. (19:07) And that means policyholders in higher-risk areas who will pay considerably higher premiums because of these models will never know if their rates are fair.

Speaker 4
(19:16) Since it has now become a component of California homeowners' insurance premiums, we take issue with the fact that there's no real way to tell how accurate these are going to be. (19:28) Meanwhile, consumers in higher-risk areas are paying considerably higher premiums due to the introduction of these models, or they will if these rate filings using models are approved. (19:38) And so that's the primary concern.
(19:40) There's really no way to see inside the black box. (19:43) The thing that is terrifying for me as an actuary and consumer advocate is reliance on a single model and just saying, Well, we put our data in, and it spit out this thing, and everybody's rates are going up.

Speaker 1
(19:56) Which brings us back to the law that Consumer Watchdog's founder Harvey Rosenfield helped pass with the blessing of California voters about 35 years ago, Proposition 103.

Speaker 2
(20:06) So one of the things that Prop 103 required was that insurance companies in California had to open their books and justify their rates and premiums. (20:16) Proposition 103 says anything that has to do with the creation or establishment of a rate or premium has to be publicly justified, has to be transparent, so that independent people, consumers, lawmakers, policymakers, scientists, government officials can assess for themselves whether these models, these software models are accurate, are reliable, and non-discriminatory, not biased.

Speaker 1
(20:43) Insurance companies have seized on the fires in California and increasing weather disasters across the country as a perfect excuse to dump these disclosure rules.

Speaker 2
(20:52) The advent of computers and the advent of the Internet in the late 1990s greatly exacerbated this problem because it allowed insurance companies to engage in old-fashioned discrimination in the guise of technology and progress and the infallible computer, which of course we know computers and insurance software, not infallible, programmed by humans for human profit-making purposes. (21:19) The industry now, it's a multi-billion dollar industry in the United States of collecting people's data without their permission.

Speaker 1
(21:27) Unfortunately, government regulators like the California Department of Insurance aren't doing their jobs in protecting policyholders from these black box rate hikes.

Speaker 2
(21:35) Basically, the insurance companies said to Californians, we're going to hold you hostage and the ransom is higher insurance rates and deregulation. (21:43) So the insurance commissioner, Ricardo Lara, said, okay, go ahead and use models and you're allowed to do it in secret. (21:50) And the fundamental problem is not so much that they want to use models and algorithms, but they want to use them and keep them secret.

Speaker 1
(21:59) Verisk also sells insurance companies its risk model, FireLine, that assigns your individual wildfire risk score. (22:06) Insurers use that to decide who or who not to cover and who pays more because of fire risk. (22:11) Those scores, other than the number, also are not explained to policyholders.
(22:15) But like your credit score, they have an outsized impact on financial stability. (22:19) In this case, your ability to buy and afford insurance. (22:22) One California resident we spoke with named Mark Burton saw his AAA premium skyrocket to almost $15,000.
(22:29) The reason? (22:29) The Verisk-owned FireLine risk score determined it was due to his, quote, fuel load, slope, and road access to the property, end quote. (22:36) It's according to a letter AAA sent him.
(22:38) This is despite his home being built on a flat spot with oak trees and grass, but no underbrush. (22:43) Mark makes sure to keep plenty of room between the house and any vegetation and keeps lower tree branches trimmed to prevent grass fires from catching on trees.(22:52) Meanwhile, companies are doubling down on tech.
(22:55) In September of this year, Verisk launched Exact AI, integrating artificial intelligence to, quote, streamline property claims management and reduce processing costs by up to 70%.(23:06) Verisk also said the platform automates tasks like photo labeling and ALE receipt categorization. (23:13) That's when companies have to pay for your temporary housing and meals.
(23:16) And cutting per claim costs from $12 to $25 down to $3 to $8 and accelerating resolution times. (23:23) The tech will take humans out of the loop for the claims process. (23:26) Forget adjusters not coming to your home.
(23:28) Now they won't even be looking at pictures of your home. (23:31) That's up to the robots.(23:32) Policyholders aren't even told about these programs like 360 value and Xactimate.
(23:38) Bill May from earlier.

Speaker 6
(23:40) I didn't sign a contract for Xactimate. (23:43) I didn't sign a contract for getting paid out too little. (23:49) I signed a contract for reasonable and necessary expenses to rebuild.
(23:53) Even if they're more, they want to have this closed system, this proprietary business trying to magically figure out what the house was worth.

Speaker 1
(24:06) Bad guesses, incomplete data, and faulty conclusions by algorithms and AI behind programs like 360 value and Xactimate are being ignored by Verisk and insurance companies that use it. (24:17) The result is stories like Barbara and Will's that keep repeating. (24:21) Homeowners not getting what they paid for after a disaster.
(24:25) Companies continue using Verisk's black box risk models to deny coverage or price people out of the regular market, pushing them into the state insurer of last resort, the Fair Plan. (24:43) As we approach the one-year anniversary of the Eaton and Palisades fires, fire survivors are still stuck in limbo, and many others can't get the insurance they need. (24:52) Insurance companies are built on data.
(24:54) They can't do business without it. (24:56) But what Verisk's start-to-finish stranglehold on our insurance policies has made painfully clear is we won't get a fair deal on that insurance until the data that shapes the whole policy is transparent. (25:08) Barbara used data in her Xactimate report as leverage to get paid more.
(25:12) It's how policyholders can fight back. (25:15) We at Consumer Watchdog are fighting for a public wildfire model in California, so we don't have to take their word for it. (25:21) Governor Newsom just signed a law, SB 429, to take the first step.

Speaker 7
(25:26) My name's Dave Cortese, and I'm a California state senator representing primarily the San Jose area. (25:33) To the average person, your fire risk score should be something that you can check against SB 429 data in the future.

Speaker 1
(25:41) The bill will create a fire risk model, but one that is public and transparent. (25:46) It will simulate wildfire damage and generate risk scores for every property in California, so policyholders, legislators, academics, everyone can be empowered with information. (25:58) The goal is to shed light on why a fire risk has increased.

Speaker 7

(26:02) If you want to know the answer to why, we're going to try to give you that, too. (26:06) And we're going to send you down this sort of parallel path of getting some numbers from the SB 429 model. (26:14) And maybe that helps to make an argument at some point with your own insurance company.
(26:19) Transparency.

Speaker 1
(26:19) That's what we're asking for.