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Comments For July 13, 2023 Workshop Examining Catastrophe Modeling and Insurance, REG-2023-00010

Dear Mr. Phenix,

I write on behalf of the non-profit United Policyholders ("UP") to provide comments regarding Catastrophe ("CAT") Risk Modeling and California's insurance regulatory system. We appreciate the opportunity to contribute to the Department's fact-finding, as well as all the department's efforts to advance mitigation and restore affordable, available options for property owners throughout the state. We recognize that your agency has been under considerable lobbying pressure from insurance industry advocates on this topic, but we firmly believe that allowing the unfettered use of CAT models for rate setting will create more problems than it will solve.

This year marks United Policyholders' ("UP") 32nd year as a non-profit that educates and assists insurance consumers, helps solve insurance-related problems and advocates for fair insurance practices, laws and regulations. Through a Roadmap to Preparedness program, UP provides information and assistance that helps home and business owners and renters use lessons learned the hard way by wildfire victims to buy and maintain adequate insurance, inventory assets and be resilient to disasters.

Through a Wildfire Risk Reduction and Asset Protection initiative, UP is promoting and working to facilitate home hardening and defensible space at the individual and community levels through the state and advocating for insurers to incentivize and reward risk reduction through premium discounts and renewals.

Thanks to a grant from the Governor's Office of Emergency Services, UP created and is maintaining an online resource center where Californians can easily find mitigation help in their region, https://uphelp.org/preparedness/wrap-resource-center. Through that same initiative, a UP-led working group of stakeholders including CDI and IBHS personnel, firefighting agencies, fire scientists, Fire Safe Council and Firewise Community representatives worked for two years to build consensus on effective mitigation techniques and support the Safer From Wildfires workstream and adoption of the Mitigation in Rating Plans and Wildfire Risk Models Regulation.

As an official consumer representative at the tri-annual meetings of the National Association of Insurance Commissioners and frequent attendee at conferences and events where risk modeling firms present, I have been observing those firms and representatives using their considerable resources to lobby all across the country for the freedom to use CAT models in their rating plans. Modelers have convinced their insurance industry clients that using their CAT models to set rates will help insurers remain profitable in the face of increasingly severe weather events associated with climate change.

I have listened to their presentations and arguments, as well as the concerns expressed by regulators that opaque aspects of the models (and claims of proprietary information) make it impossible for their rate review teams to evaluate the integrity of the assumptions that underlie their projections. In addition to that very serious problem, CAT models have been developed by for-profit companies to sell to for-profit insurers customers – and logic dictates they overstate risk to justify higher rates and create larger profit cushions for insurers. In addition, we remain unconvinced that CAT models are fully taking into account the coverage reductions that insurers are implementing through high and multiple deductibles and limits on indemnification for water and smoke damage.

For those reasons, and because UP has seen how CAT models have caused premiums to spike and negatively impact property owners, property values and real estate transactions, United Policyholders has consistently urged regulators to prevent or strictly limit their use.

Together, modeling firms and insurers have been a formidable lobbying force across the country, and we recognize the pressure that is putting on the California Department of Insurance. However, reversing longstanding consumer protections in this state, particularly at a time where ***premiums are already doubling and tripling in many regions***, is very likely to make a bad situation worse.

The possibility of allowing modeled catastrophic loss projections to be broadly used in California ratemaking has been off the table for decades, except in very limited applications. Such models are currently utilized in earthquake ratemaking for California where, fortunately, major loss events have few and far between. And modeled projections have also been allowed for the California FAIR Plan due to the relatively limited population of policyholders and concentrations of risk inherent in that operation. These limited exceptions have been made out of necessity, but should not be expanded wholesale to the entire marketplace.

The aftermath of implementation of CAT models has not been reassuring. Unlike rating tools that are based on historical facts and actual weather and claim events, CAT models apply forward-looking algorithms to project future losses. They have a track record of decreasing availability and affordability. In 2006, when RMS rolled out a change to their hurricane catastrophe model in RiskLink 6.0, it caused extreme home insurance price spikes in Gulf Coast states that were devastating to property owners and communities and is estimated to have cost Florida homeowners $82 billion[1]. In the aftermath of the National Flood Program implementing Risk 2.0 (a CAT model) in 2022, premium increases have been so painful to consumers that ten states have sued to reverse its impact. Louisiana Attorney General Jeff Landry was recently quoted as saying; "Risk Rating 2.0 flood insurance policy has now become a natural disaster of its own."[2]

And while proponents of CAT models claim the models make it easier for insurers to give mitigation discounts, reports came rolling into the Coalition for Sustainable Flood Insurance (of which UP is a member) that implementation of the Risk 2.0 model was causing mitigation credits to disappear.

[1] http://rogerpielkejr.blogspot.com/2012/01/cat-model-mayhem.html
[2] https://www.insurancejournal.com/news/national/2023/06/02/723619.htm#

UP as well as most consumers understand and accept that climate change and inflation mean that insurance is going to cost more. But the question is how much more. It is up to the Department to ensure that premium increases are reasonable and fair. Allowing unfettered use of CAT models will eliminate meaningful oversight of property insurance rate setting, lead to bad outcomes for Californians and undermine the current transparency of the rate approval calculation so as to completely negate all the other protections in the prior approval process.

Since the passage of Proposition 103, we have been very fortunate in California to have a regulatory system that is transparent and has critical guardrails to protect consumers from excessive rates for property-casualty insurance coverages. A decision to broadly allow catastrophe rate models could undo those protections.

Certainly there can be differences of opinion between those with expertise in the current ratemaking formula. For example, there can be disagreement in the analysis of a rate filing over the selection of the most appropriate trend factor to select for the amended rate. But the level of subjectivity in even a relatively simplistic catastrophe model would be exponentially greater. Before adopting the “nuclear option” of widespread use of CAT models, the California Department of Insurance should recognize there are other solutions.

For example: insurers could be allowed to apply a trend factor to past catastrophe losses to recognize the increasing frequency of wildfires; or insurance companies could adopt industrywide California catastrophic loss experiences, rather than individual company experiences, to create more credible models of loss likelihood. These two options retain the transparency and objectivity that exists in the current regulatory formula.

UP urges the Department to be very considered in any determination regarding the broad use of modeled projections in California ratemaking and pursue all other possibilities for dealing with the availability crisis: Can new insurers be encouraged to enter the market and ease concentration concerns? Are there regions where focused mitigation efforts can bring the risk level down to the extent it will open up availability of coverage?

Finally, UP urges the Department to consider that the insurance industry’s support for this momentous change in the rate regulations is an indication that insurers clearly expect to receive higher rates from the models. But there is no corresponding guarantee that insurers would expand their eligibility or increase concentration levels. Allowing premium increases without any meaningful and proportionate expansion of availability would be a very poor outcome for Californians.

Thank you in advance for your consideration of our input and your work on this important matter.

Sincerely,

Amy Bach

Amy Bach, Esq. Executive Director
United Policyholders