

California Public Disclosure Rule May Mean Trouble for Insurtech

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Key Points

- Insurtech start-ups are using technology to improve the underwriting process and obtain a competitive advantage.
- The CDI's new legal opinion clarifies that even proprietary underwriting rules must be available to the public.
- While courts may have the last word, companies operating in the insurance space should be aware of, and prepare for, this policy shift.

Over the past several years, tech-savvy players and start-ups have been bursting into the insurance sector in droves. Their goal: to leverage new technologies and disrupt every aspect of the insurance value chain, from innovative new products (such as Metromile's [pay-per-mile insurance](#)) to consumer-friendly claims-handling (such as Lemonade's [three-second claims payment](#)).

Given the continuing explosion of data and the breathtaking potential of AI, one of the frontiers for innovation that seems most promising is that of underwriting. Consumers are creating data faster than ever, and companies are racing to gather it, mine it and, hopefully, make sense of it in a way that gives them a competitive advantage.

To this end, a property and casualty insurer might, for example, apply machine-learning to satellite imagery of residential rooftops to identify the most and least profitable business risks; or a commercial liability insurer might scan millions of peer-reviewed science journals to determine whether a chemical used in a company's consumer product is likely to give rise to future litigation. These examples are just [the tip of a massive iceberg](#).

Perhaps more than any other area of insurance, the pricing and underwriting process is riddled with regulatory issues. Not only are insurers required to navigate a 50-state patchwork of [often contradictory regulatory regimes](#), but, in the event that they do design truly innovative underwriting processes for which they might enjoy a competitive advantage, there is no guarantee that they will be able to protect those processes from their competitors. In fact, in California, a state that many (if not most)

Contact

Shawn Hanson
Email
San Francisco
+1 415.765.9528

Nicholas J. Gregory
Email
San Francisco
+1 415.765.9562

insurtechs call home, a recent [legal opinion](#) from the state's Department of Insurance (CDI) makes clear that they will not. Below, we provide the background of California's public inspection approach to insurance rates, the recent legal opinion that signals a policy shift and our analysis of what this shift might mean moving forward.

Background of Public Inspection Approach

In 1988, California voters passed Proposition 103, which provided for consumer participation in the administrative insurance rate-setting process. Among other things, Proposition 103 led to Insurance Code, Section 1861.05(b), which requires a property and casualty insurer to file a complete rate application with the commissioner before changing its rates. Once the CDI receives an application, it must provide public notice of the application and make it available for public inspection so that consumers may review it and request a hearing.

Under the statute, the applicant has the burden of showing that the requested rate change is justified and does not result in rates that are “excessive, inadequate, or unfairly discriminatory.” According to the CDI, the purpose of this statute was to “protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians.”

One downside of the public inspection process, of course, was that insurers, which often compete on their ability to develop optimal underwriting models, have a vested interest in keeping proprietary underwriting models confidential. In light of this problem, the CDI's historical approach has been to treat underwriting rules as provisionally confidential so long as they were marked “confidential,” “proprietary” or “trade secret.”

The Opinion

On Aug. 10, 2018, the CDI took the extraordinary step of issuing a [legal opinion](#) on the issue of “confidential” underwriting rules. The opinion—only the fourth since 2014—contained a discussion of the history of the public inspection process, as well as a statutory analysis of the Insurance Code's public-notice provisions. The CDI concluded that “[p]roviding public access to all information submitted to the Commissioner . . . is consistent with Proposition 103's goal of fostering consumer participation in the rate review process.” As a result, “underwriting rules filed in connection with the rate application pursuant to [the] Insurance Code . . . must be available for public inspection . . . regardless of whether such underwriting rules are marked ‘confidential,’ ‘proprietary,’ or ‘trade secret.’”

What's Next?

The CDI's opinion and accompanying [press release](#) deliver full-throated support to an open and transparent rate-setting process. Thus, in the debate between full consumer participation and the protection of trade secrets, the CDI has, it appears, conclusively picked a side.

What does this mean for insurers?

First, it means that companies operating in this space need to be prepared for this policy shift, whether determining in which jurisdictions to operate or considering proactively how to frame and disclose underwriting rules to ensure that they have provided a “complete” rate application sufficient for approval.

Second, setting aside questions of policy preference, a question remains: Did the CDI get the law right? The CDI is interpreting a statute passed by the California legislature, something agencies often do, but an agency’s interpretation of a statute is far from the final word on the issue; in fact, unreasonable agency interpretations are routinely rejected by courts. While at the federal level, the “Chevron doctrine” mandates strong deference of agency interpretation of ambiguous legal texts, that doctrine does not apply in California, where courts exercise independent judgment when reviewing agency interpretations of law—potentially lowering the bar for a challenge.

This dynamic was on full display recently when the insurance commissioner intervened in a case, *Heckart v. A-1 Self Storage Inc.*, at the California Supreme Court. The case involved the question of what types of commercial contracts can reasonably be considered “insurance” such that they will be subject to regulation under the Insurance Code. While the commissioner, in arguing for a more expansive definition of the term “insurance,” requested the court to “give weight to his official, considered views of the law,” the court declined to do so and instead rejected the commissioner’s legal position outright. (For more details, [here](#) is our write-up of the decision.)

In other words, while the CDI has picked a side, it is not yet clear that it has picked the winning side as a matter of law. California’s courts will have the final say there. Given the implications of this new agency opinion, and especially the potential impact on the industry’s ability to innovate, expect this issue to wind up in those courts sooner rather than later.