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Bulletin 219

PRICE OPTIMIZATION

This Bulletin is directed to all personal lines insurers doing business in Indiana. The purpose of this Bulletin is to alert insurers to the Department's position that the use of price optimization in establishing rates is not permitted.

Price optimization includes using data collection and analysis to predict which consumers will accept higher rates without changing insurers and/or varying premiums based upon factors that are unrelated to risk of loss so that each insured is charged the highest price that the market will bear. One of the components of price optimization is demand price elasticity modeling. Price optimizing predicts which consumers are more or less "price sensitive." Predictions may be based on, among other things, a consumer's reaction to past rate changes and information collected by an agent or through the insurance application process. This may include data elements that measure consumer purchasing patterns and socioeconomic status. There is growing concern by the Department that insurers are shifting from cost-based ratemaking and increasingly introducing price sensitivity into their rating methodologies.

Insurers should also be mindful of the following specific Indiana insurance laws that companies must comply with on an ongoing basis, with or without the Department's direct intervention:

- IC 27-1-22-3(a)(4) states that rates shall not be excessive, inadequate, or unfairly discriminatory.
- IC 27-4-1-4(a)(7)(C)(iii) prohibits making or permitting unfair discrimination between persons of the same class involving essentially the same hazards.
- IC 27-1-22-3(a)(2) states that "classification rates may be modified to produce rates for individual risks in accordance with rating plans which establish standards for measuring variations in hazards or expense provisions, or both. Such standards may measure any difference among risks that can be demonstrated to have a probable effect upon losses or expenses."
- IC 27-1-22-4(a) requires every insurer to file with the commissioner "every manual of classifications, rules, and rates, every rating schedule, every rating plan, and every modification of any of the foregoing which it proposes to use."
- IC 27-1-22-5(e) states, "No manual of classifications, rule, rate, rating schedule, rating plan, or any modification of any of the foregoing which establishes standards for measuring variations in hazards or expense provisions, or both, which has been filed pursuant to [IC 27-1-22-4] shall be disapproved if the rates produced thereby meet the requirements of [IC 27-1-22-3]."

The Department views a rating factor or rating methodology that adapts rates based on considerations other than risk to be at high risk of violating Indiana insurance laws, particularly IC 27-1-22-3, which requires that rates not be excessive, inadequate or unfairly discriminatory. When a rating factor or rating methodology adjustments result in classification rates outside of a

reasonable range of cost-based estimates, or lead to unfairly discriminatory rates, rates are not in compliance with the law.

All companies using price optimization to rate policies being sold in Indiana should submit a new rate filing within 90 days of the issuance of this Bulletin. Companies that fail to comply with this bulletin and are later determined to be using price optimization in the manner described may be subject to disciplinary action.

INDIANA DEPARTMENT OF INSURANCE

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Insurance Commissioner