BULLETIN 2015-01

Price Optimization

Effective January 29, 2015

The Ohio Department of Insurance ("Department") recently received inquiries about the use of price optimization. While price optimization has no absolute definition, it generally refers to an insurer's practice of varying premiums based upon factors that are unrelated to risk of loss in order to charge each insured the highest price that the market will bear.

Ohio insurance law prohibits charging unfairly discriminatory rates, requires that rates be based upon risk, and requires differences among risks to have a demonstrable probable effect on losses or expenses. Ohio Revised Code ("ORC") 3901.21(M) defines "unfair and deceptive acts or practices in the business of insurance," which include:

> Making or permitting any unfair discrimination between individuals of the same class and of essentially the same hazard in the amount of premium, policy fees, or rates charged for any policy or contract of insurance, other than life insurance, or in the benefits payable thereunder, or in underwriting standards and practices or eligibility requirements, or in any of the terms or conditions of such contract, or in any other manner whatever.

Additionally, ORC 3937.02 provides:

> (C) Risks may be grouped by classifications for the establishment of rates and minimum premiums. 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 differences among risks that can be demonstrated to have a probable effect upon losses or expenses.
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> Classifications or modifications of classifications, or any portion or any division thereof, of risks may be predicated upon size, expense, management, individual experience, purpose of insurance, location or dispersion of hazard, or any other reasonable considerations, provided such classifications and modifications apply to all risks under the same or substantially the same circumstances or conditions.

(D) Rates shall not be excessive, inadequate, or unfairly discriminatory.

Similarly, ORC 3935.03(B) provides that "[r]ates shall not be excessive, inadequate, or unfairly discriminatory."

While risk classifications are widely accepted as a legitimate insurance actuarial principle, and Ohio insurance laws permit insurers to classify risks based upon size, expense, management, individual experience, purpose of insurance, location or dispersion of hazard, or any other reasonable consideration, the fundamental factor underlying insurance rates is that they reflect a risk of loss.

Price optimization, however, involves gathering and analyzing data related to numerous characteristics specific to a particular policyholder that are unrelated to risk of loss or expense. Though not an exhaustive list, the Department has been presented with factors such as: whether the policyholder has complained about his or her policy, the amount or percentage change of the policyholder's auto premium at renewal in prior years, and the amount or percentage change of the policyholder's homeowners premium at renewal in prior years. From this and similar data, insurers are able to determine the "price elasticity of demand," or how much of a premium increase a particular policyholder will tolerate before switching insurance carriers. Thus, price optimization techniques allow insurers to set premiums based on an analysis of individual policyholder behavior reflecting a willingness to pay higher premiums than others—a factor completely unrelated to risk of loss or expense.

The use of price optimization represents a departure from traditional cost-based rating and can result in two insureds with similar risk profiles being charged different premiums. Therefore, by its nature, price optimization involves "discriminat[ing] between individuals of the same class and of essentially the same hazard" based on factors which do not have a demonstrable "probable effect upon losses or expenses." See ORC 3901.21(M) and 3937.02(C).

Consequently, the use of price optimization results in rates that are unfairly discriminatory in violation of ORC 3901.21(M), 3937.02(C) and (D), and 3935.03(B). Any insurer currently utilizing price optimization in any manner similar to that described above to rate insurance policies in Ohio must submit a SERFF filing that is compliant with this Bulletin no later than March 31, 2015, with proposed effective dates no later than May 31, 2015 for new business and June 30, 2015 for renewal business. The filing submission must identify the SERFF tracking number of the filing that is being replaced or corrected.

Failure to submit the above-described filing in compliance with this Bulletin may result in administrative action. Any questions or comments regarding this Bulletin should be addressed to Thomas Botsko at (614) 644-2635 or property.casualty@insurance.ohio.gov.

Superintendent of Insurance

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