



THE ABILITY OF INSURERS TO USE PRICE OPTIMIZATION GIVEN RECENT STATE ACTIONS

By: [Daniel A. Cotter](#)

Price optimization is a method of using the data collected by personal lines insurers to apply predictive analytics to determine consumers' rate sensitivities and adjust the premium accordingly. The industry and regulators disagree on what price optimization is, how it is to be defined, and whether it is an acceptable rating methodology. In the last year, the National Association of Insurance Commissioners ("NAIC") and some states have taken actions to address the question. This regulatory update provides an overview of the activity that has taken place in recent months.

Background and Activity

Earlier this year, the NAIC instructed the Casualty Actuarial and Statistical Task Force to investigate the topic of price optimization and prepare a white paper for dissemination and discussion. However, several jurisdictions had already taken action before the NAIC commissioned the white paper. To date, California, Florida, Indiana, Maryland, Ohio, Vermont and Washington, D.C. have issued directives to personal lines insurers to cease and desist from utilizing price optimization because the practice constitutes "unfair discrimination" and violates state insurance laws. At least one state, Washington, has issued a warning regarding use of price optimization instead of a prohibition, doing so in (June 2015).

Maryland was the first state to prohibit the use of price optimization in its [Bulletin 14-23](#) issued on October 31, 2014. The Bulletin defines price optimization as "the practice of varying rates based on factors other than risk of loss." Next to prohibit the use of price optimization was Ohio, which in its [Bulletin](#) described the practice as pricing "based upon factors that are unrelated to risk of loss in order to charge each insured the highest price that the market will bear." California followed in February 2015 with a [notice](#) prohibiting price optimization defining the term as "any method of taking into account an individual's or class's willingness to pay a higher premium." In the last five months, Florida ([OIR-15-04M](#)), Washington (no bulletin or notice formally issued), Vermont ([Bulletin](#)

[No. 186](#)), Indiana ([Bulletin 219](#)) and the District of Columbia have all weighed in on the issue, with each jurisdiction using its own definition of the term "price optimization." The District of Columbia's prohibition was the most recent; its Bulletin [15-IB-06-8/15](#) issued on August 25, 2015, defined the term as "charging the maximum premium that it expect[s] an individual or class of individuals to bear."

Problems for the Industry

Given the actions outlined above and the growing number of states prohibiting the use of price optimization, the insurance industry faces uncertainty as to what extent they may utilize price optimization in rating personal lines insurance. A second problem is the difference in how the industry defines price optimization as opposed to the narrow and inconsistent definitions applied by the jurisdictions that have addressed the issue to date. While the issues are being addressed by various states and the NAIC, there is some risk for property and casualty insurers that their practices will be reviewed and market conduct activity may ensue by various insurance departments.

Conclusion

Price optimization has long been used in unregulated industries. In addition, property and casualty insurers have long used the ratemaking process as a starting point, taking into account more qualitative factors in pricing such as retention and conversion rates, and often temper price increases over a several-year period to prevent overly burdensome rates. As a result, many in the industry disagree with regulators such as the Ohio Department of Insurance, which asserted in its Bulletin that price optimization "represents a departure from traditional cost-based rating." Hopefully, the anticipated white paper commissioned by the NAIC will help address the open questions and give guidance to both regulators and property and casualty insurers on what practices are permitted when it comes to price optimization. ⚖️

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