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Colorado
Insurance Department Publications

INSURANCE DIVISION BULLETINS

Bulletin B-5.36

Concerning the use of price optimization in establishing rates

October 10, 2015

I. Background and Purpose

The purpose of this bulletin is to provide entities with the Colorado Division of Insurance's (Division) interpretation of statutes relating to the use of "price optimization" or "elasticity of demand" in establishing rates.

Bulletins are the Division's interpretations of existing insurance law or general statements of Division policy. Bulletins themselves establish neither binding norms nor finally determine issues or rights.

II. Applicability and Scope

This bulletin is intended to apply to all insurers that file rates for personal lines property and casualty insurance with the Division's Rates and Forms Section.

III. Division Position

It has come to the Division's attention that some insurers' rates include factors, unrelated to underwriting, that consider the point at which an insured will look for coverage elsewhere due to increases in the premium charged. Their ratemaking methodologies make use of data analysis techniques that measure the willingness of individual insureds to pay higher rates for insurance coverage than other insureds with similar underwriting characteristics. Common terms used in describing this practice are "price optimization" and "elasticity of demand."

This bulletin reminds insurers that their rates must comply with Colorado insurance law, with specific reference to the following provisions:

- "Rates shall not be excessive, inadequate, or unfairly discriminatory."¹
- Factors in rates shall give "due consideration" to past and prospective loss and expense experience; catastrophe hazards and contingencies; events or trends; loadings for leveling premium rates over time or for dividends or savings to be allowed or returned by insurers to their policyholders, members, or subscribers; provisions for contingencies and allowance permitting a reasonable profit; and other relevant factors, including judgment."²
- An insurer shall not make or permit "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" . . . "or in the benefits payable thereunder, or in the underwriting standards and practices or eligibility requirements, or in the terms or conditions of such contract, or in any other manner."³

These provisions evidence a clear purpose in Colorado that insurers classify risk according to actuarially supported considerations grounded in expected losses and expenses. Moreover, insurers are expected to disclose these considerations in their filings and otherwise justify their rates. Failure to do so puts insurers at high risk of violating Colorado insurance law.

Any insurer currently using price optimization in a manner similar to that described above must submit a new rate filing to the Division of Insurance within 90 days of the issuance of this bulletin. Insurers that fail to comply with this bulletin and are later determined to be using price optimization may be subject to disciplinary action.

This bulletin does not prohibit or restrict previously acceptable practices if applied on a group basis. The aim is that similarly situated individuals should be grouped into risk classifications and treated the same with respect to insurance pricing. Likewise, the use of data analysis in developing rating methodologies does not, in and of itself, violate Colorado insurance law so long as risk classifications are based on expected loss and expense considerations, and not an individual insured's willingness to pay a given price.

IV. Additional Division Resources

A. For More Information

Colorado Division of Insurance
Rates and Forms Section
1560 Broadway, Suite 850
Denver, CO 80202
Tel. 303-894-7499
Internet: <http://www.dora.state.co.us/insurance>

B. Related DOI Regulations

- Regulation 5-1-10
- Regulation 5-1-11

V. History

- Issued October 29, 2015
 - ¹ C.R.S. § 10-4-403(1).
 - ² C.R.S. § 10-4-403(2).
 - ³ C.R.S. § 10-3-1104(1)(f)(II).

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