



Department of Business Regulation
1511 Pontiac Avenue, Bldg. 69-2
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Price Optimization in Personal Line Ratemaking

This Bulletin is applicable to all property and casualty insurers issuing personal lines policies in Rhode Island.

The NAIC Casualty Actuarial and Statistical (C) Task Force is currently in the process of drafting a “white paper” analyzing price optimization and its use in insurance ratemaking. While there is no universally accepted definition of price optimization, the practice, in some of its applications, involves the judgmental use of factors not specifically related to a policyholder’s risk profile to help determine or adjust his or her insurance premium. An example would be using an individual policyholder’s response to previous premium increases to determine how much of a premium increase the policyholder will tolerate at renewal before engaging in comparison shopping or switching to a different insurer. This practice can result in two policyholders receiving different premium increases even though they have the same loss history and risk profile.

Property and casualty insurers doing business in Rhode Island are reminded that all ratemaking must conform to the statutory requirements contained in R.I. Gen. Laws §§ 27-6-1, 27-9-1 and 27-44-1. Specifically insurers are reminded that rates must not be “...excessive, inadequate or unfairly discriminatory...” A rate will be considered unfairly discriminatory if price differentials fail to reflect equitably the differences in expected losses and expenses for different classes of policyholders. *Both base rates and rating classes must be based on factors specifically related to an insurer’s expected losses and expenses.* While insurers may employ judgment in setting their rates, judgmental adjustments to a rate may not be based on non-risk related factors such as “price elasticity of demand” which seek to predict how much of a price increase a policyholder will tolerate before switching to a different insurer. The use of such factors not only unfairly discriminates between policyholders of the same risk profile, *but is also directly in conflict with the statutory principles that underlie Rhode Island’s “open and competitive” property and casualty marketplace.*

The Department does not intend this Bulletin to prohibit or restrict such practices as capping or transitional pricing if applied on a group basis. Insurers should group individual policyholders into credible risk-based classifications and treat similarly situated policyholders the same with respect to insurance pricing. Likewise, the use of sophisticated data analysis to develop finely tuned methodologies with a multiplicity of possible rating cells is not, in and of itself, necessarily a violation of Rhode Island’s rating laws as long as the classifications are based strictly on risk of loss and not on willingness to pay or “elasticity of demand.”

Any insurer that uses price optimization to rate policies delivered or issued for delivery in Rhode Island should submit revised filings that remove such factors within 60 days after the date of this Bulletin. Insurers must also disclose in SERFF- Question #17 of the RI Rate Procedural Informational Summary Form, whether the company uses non-risk-related factors such as price optimization or elasticity of demand to help determine personal insurance premiums. Insurers with currently pending rate filings should amend them to disclose this information, if applicable. Companies that fail to do so and are later determined to have used price optimization or elasticity of demand or failed to disclose such use to the Department may be subject to disciplinary action.

Joseph Torti III
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