State of Vermont
Department of Financial Regulation
89 Main Street
Montpelier, VT 05620-3101

For consumer assistance:
[Banking] 888-568-4547
[Insurance] 800-964-1784
[Securities] 877-550-3907
www.dfr.vermont.gov

VERMONT DEPARTMENT OF FINANCIAL REGULATION

DIVISION OF INSURANCE

Insurance Bulletin No. 186

PRICE OPTIMIZATION IN PERSONAL LINES RATEMAKING

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

Some property and casualty insurers have been relying upon a practice called "price optimization" to help determine the premiums that they will charge to policyholders. 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 Vermont are reminded that all ratemaking must conform to the statutory requirements contained in Chapter 128 of Title 8 V.S.A. Specifically, insurers are reminded that, under Section 4685(d) of Title 8, unfair discrimination is considered to exist if price differentials "fail to reflect equitably the differences in expected losses and expenses" for different classes of policyholders. In classifying policyholder risks for ratemaking purposes, insurers are allowed to use rating plans "which provide for recognition of probable variations in hazards, expenses, or both." *See* 8 V.S.A. § 4686(2). *As these sections make clear, 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 Vermont's "open and competitive" property and casualty marketplace.*

The Department recognizes that not all insurers have adopted the practice of price optimization. To help the Department identify the possible use of inappropriate rating factors, insurers are directed that henceforth all personal lines rate filings must disclose on the SERFF General Information page whether the company uses non-risk-related factors such as "price elasticity of demand" (as defined above) to help determine the insured's final premium. Rate filings currently under review by the Department should be amended to disclose this information. The authority for this requirement is contained in 8 V.S.A. § 4688(a)'s language that "every insurer shall file with the Commissioner all rates and supplementary rate information, and supporting information which are to be used in this State." The statutory definitions of "supplementary rate information" and "supporting information" make it clear that these terms include *all* factors that are used to help determine a policyholder's final premium. *See* 8 V.S.A. § 4683 (18) and (19). A failure to comply with this directive shall be considered a violation of Section 4688(a).

Inquiries concerning this bulletin should be directed to Phil Keller, Director of Insurance Regulation, or Kevin Gaffney, Director of Rates & Forms.

Dated: June 24, 2015

Susan L. Donegan

Susan L. Donegan, Commissioner