



INFORMATIONAL MEMORANDUM

OIR-15-04M

ISSUED

May 14, 2015

Florida Office of Insurance Regulation

Kevin M. McCarty, Commissioner

TO ALL PROPERTY AND CASUALTY INSURERS AUTHORIZED TO DO BUSINESS IN FLORIDA

USE OF PRICE OPTIMIZATION IN PREMIUM DETERMINATION

The purpose of this memorandum is to emphasize the requirements of the Florida Insurance Code in connection with insurers' use or potential use of Price Optimization in determining policyholder premiums.

There has recently been increased discussion regarding the use of "price optimization" tools in determining the premium to be charged to policyholders. Regardless of the reasons behind this increased discussion, insurance premiums remain subject to the regulatory requirements set forth in the Florida Insurance Code and the Florida Administrative Code.

"Price optimization" does not have a universally recognized definition. In a regulated insurance context and for the purpose of this informational memorandum, price optimization is a process for modifying the insurance premium that would otherwise be charged to an insured or class of insureds in order to maximize insurer retention, profitability, written premium, market share, or any combination of these while remaining within real world constraints. Price optimization utilizes the economic concept of "price elasticity of demand," which is a measure of the responsiveness of the quantity of a good or service purchased to a change in its price. Advocates of price optimization have pointed to such non-risk-related items as cross-selling opportunities, consumer retention, and conversion rates as potential benefits of the process. However, it is possible for an insurer to use price optimization or price elasticity of demand for the purpose of price discrimination, which is when the insurer charges different prices for the same product to different market segments with reduced regard for expected losses and expenses.

Section 627.062(2)(b), Florida Statutes, requires the Office of Insurance Regulation ("Office") to review a rate filing to determine if a rate is excessive, inadequate, or unfairly discriminatory in accordance with generally accepted and reasonable actuarial techniques. Further, Section 627.062(2)(e)6., Florida Statutes, provides that a rate shall be deemed unfairly discriminatory as to a risk or group of risks if the application of premium discounts, credits, or surcharges among such risks does not bear a reasonable relationship to the expected loss and expense experience among the various risks. Pursuant to Section 627.062(g), Florida Statutes, the Office is required to initiate proceedings to disapprove a rate that it finds on a preliminary basis may be excessive, inadequate, or unfairly discriminatory. Similar criteria apply to private passenger motor vehicle insurance, in accordance with Section 627.0651(2), (7), (8), Florida Statutes.

Risk classification is an actuarially accepted technique in the Statement of Principles Regarding Property and Casualty Insurance Ratemaking of the Casualty Actuarial Society and the Actuarial

Standard of Practice Number 12 of the Actuarial Standards Board. The latter source states that an actuary should select risk characteristics that are related to expected outcomes. This relationship is demonstrated when it is shown that the variation in reasonably anticipated experience correlates to the risk characteristic. Rates within a risk classification system would be considered fair if differences in rates reflect material differences in expected cost for risk characteristics.

Price optimization involves analysis and incorporation of data not related to expected cost for risk characteristics—that is, it involves factors not related to expected loss and expense experience. For example, such data may include the prior year changes in premium and whether policyholders renewed subsequent to such change. Therefore, the use of price optimization results in rates that are unfairly discriminatory in violation of Sections 627.062 and 627.0651, Florida Statutes.

Insurers that have used price optimization in the determination of the rates filed and currently in effect should submit a filing to eliminate that use. Insurers should ensure that any filings subsequent to the date of this memorandum do not utilize price optimization in any manner.

If you have questions regarding this memorandum, please contact Sandra Starnes, Director, Property and Casualty Product Review, Florida Office of Insurance Regulation at Sandra.Starnes@flor.com or (850) 413-5344.