THE STATE
of ALASKA
GOVERNOR BILL WALKER

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BULLETIN B 15-12

TO: ALL PROPERTY AND CASUALTY INSURERS WRITING PERSONAL LINES POLICIES IN THE STATE OF ALASKA AND OTHER INTERESTED PARTIES

RE: PRICE OPTIMIZATION IN RATEMAKING

While there is no universally accepted definition of "price optimization", the practice, in some of its applications, involves the use of factors not specifically related to an insured's expected losses and expenses but are used to help determine or to adjust an insured's 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 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. It can also result in premiums that are excessive or inadequate.

Property and casualty insurers doing business in Alaska are reminded that all ratemaking must comply with several important provisions of Alaska law, including:

1. Rates shall not be excessive, inadequate, or unfairly discriminatory;[1]
2. An insurer may not make or permit an unfair discrimination between insureds or property having like insuring or risk characteristics, in the premium or rates charged for insurance, or in the dividends or other benefits payable thereon, or in any other of the terms and conditions of the insurance;[2]
3. An insurer's rate filing must be consistent with the estimate of future costs of a risk transfer as established in the Casualty Actuarial Society's Statement of Principles Regarding Property and Casualty Ratemaking, adopted May 1988. The costs must include estimated future losses, loss adjustment expenses, and other expenses.[3]

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 policyholder characteristics specifically related to an insurer's expected losses, expenses, or policyholders' risk. While insurers may employ actuarial judgment in setting their rates, judgmental adjustments to a rate may not be based on non-risk related policyholder characteristics such as an individual's "price elasticity of demand" which

[1] AS 21.39.030(a)
[2] AS 21.36.120(c)
[3] 3 AAC 29.250(c)

seek to predict how much of a price increase an individual policyholder will tolerate before switching to a different insurer.

Insurers are also reminded that, with limited exceptions outlined in the statute, "every manual, minimum, class rate, rating schedule, loss cost adjustment, or rating plan and every other rating rule, and each modification of any of them that it proposes to use" must be filed with the director, and "an insurer may not make or issue a contract or policy except in accordance with the filings that are in effect for that insurer…"[4] Accordingly, considerations affecting price differentials must be disclosed and documented in rate filings.

The practice of adjusting either the otherwise applicable manual rates or premiums or the actuarially indicated rates or premiums based on any of the following is considered inconsistent with the statutory requirement that "rates shall not be…unfairly discriminatory", whether or not such adjustment is included within the insurer's rating plan:

a. Price elasticity of demand;
b. Propensity to shop for insurance;
c. Retention adjustment at an individual level; and
d. A policyholder's propensity to ask questions or file complaints.

The division does not intend this bulletin to prohibit or restrict such practices as capping or transitional pricing when applied on a group basis and in accordance with an insurer's approved filings. Insurers should group individual policyholders into justifiable, supportable, 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 rating laws as long as the classifications are based strictly on expected losses, expenses, or other justifiable, supportable risk characteristics.

If you have questions regarding this bulletin, please contact the Division of Insurance, P.O. Box 110805, Juneau, AK 99811-0805; (907) 465-2515; or via electronic mail at insurance@commerce.state.ak.us.

Dated December 8th, 2015.

Lori Wing-Heier
Director

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[4] AS 21.39.040(a) and (h)