

COMMISSIONER OF SECURITIES & INSURANCE

MONICA J. LINDEEN
COMMISSIONER



OFFICE OF THE MONTANA
STATE AUDITOR

ADVISORY MEMORANDUM

To: All Property and Casualty Insurance Carriers

From: Monica J. Lindeen, Commissioner of Securities and Insurance
Office of the Montana State Auditor

Date: September 18, 2015

A handwritten signature in blue ink that reads "Monica J. Lindeen".

PRICE OPTIMIZATION AS UNFAIRLY DISCRIMINATORY RATING PRACTICE

The Office of the Montana State Auditor, Commissioner of Securities and Insurance (CSI), has noted that property and casualty insurers are increasingly using price optimization in rating plans. "Price optimization" is the practice of varying rates based upon factors not related to risk of loss, or based upon otherwise risk-related factors applied for a purpose other than to determine risk of loss.

Some insurers use this practice to charge the highest premium an insured will pay. Price optimization models are sometimes referred to as retention models or customer lifetime value models. It is the CSI's position that the use of price optimization in rating plans constitutes an illegal, unfairly discriminatory practice.

The Montana Insurance Code prohibits unfair discrimination in rating property and casualty insurance policies. Insurance rates "may not be excessive or inadequate . . . [or] unfairly discriminatory." Mont. Code Ann. § 33-16-201(1)(a). Additionally:

An insurer may not make or permit unfair discrimination in the premium or rates charged for insurance, in the dividends or other benefits payable on

insurance, or in any other of the terms and conditions of the insurance [. . .]
between insureds or property having like insuring or risk characteristics[.]

Mont. Code Ann. § 33-18-210(3).

Price optimization models utilize various techniques including, but not limited to, applying factors such as the occurrence and frequency of a consumer's complaints, the length of time a consumer has been with the insurer, the likelihood that a consumer will shop around with other insurers, and other factors indicative of price sensitivity. The insurer then charges consumers who are determined to be less price sensitive higher premiums. Alternatively, the insurer may front-load administrative expenses for consumers deemed less likely to remain with the insurer indefinitely.

Because price optimization-derived rates deviate from risk of loss determinations, the practice can result in an insurer charging different rates to insureds of the same class or risk characteristics. For example, an individual who has complained to the insurer could receive a lower rate than an individual of the same risk characteristics who the insurer perceives is more satisfied with his or her policy. Such a result violates Mont. Code Ann. §§ 33-16-201 and 33-18-210.

Accordingly, the CSI will deny any rating plan submitted in the future that employs price optimization. Additionally, any insurer currently using a rating plan employing price optimization shall, no later than February 1, 2016: (1) notify the CSI that its current rating plan incorporates price optimization; and (2) file an updated rating plan with the CSI that does not use price optimization.

For any questions regarding this advisory memorandum, call the CSI Legal Bureau at (406) 444-2040.