Karen Weldin Stewart, CIR-ML
Commissioner

Delaware Department of Insurance

DOMESTIC/FOREIGN INSURERS BULLETIN NO. 78

TO: **ALL PROPERTY AND CASUALTY INSURERS WRITING PERSONAL LINES POLICIES IN DELAWARE, RATING ORGANIZATIONS, AND THE DELAWARE INSURANCE GUARANTY ASSOCIATION**

RE: **Price Optimization**

DATED: **October 1, 2015**

The National Association of Insurance Commissioners' ("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 price optimization has no universally accepted definition, it generally refers to an insurer's practice of varying rates based on factors other than the risk of loss in order to charge each insured the highest price that they will tolerate without shopping for alternative coverage (such as the likelihood that policyholders will renew their policies and the willingness of certain policyholders to pay higher premiums than other policyholders). Insurers use sophisticated analytics that cover not only risk of loss, but such things as how happy an individual is with their insurance company. The practice can result in two policyholders receiving different premium increases even though they have the same loss history and risk profile.

Delaware insurance law prohibits charging unfairly discriminatory rates, requires that the rates be based upon risk, and requires differences among risks to have a demonstrable probable effect on losses or expenses. While risk classification is widely accepted as a legitimate insurance actuarial principle, and Delaware insurance laws permit insurers to classify certain risks, the fundamental factor underlying insurance rates is that they reflect a risk of loss and the associated expenses of servicing and maintaining a policy.

18 Del. C. § 2503(a)(5) states:

> Risks may be grouped by classifications for the establishment of rates and minimum premiums. Classification rates may be modified to produce rates for individual risks in accordance with rating plans which establish standards for measuring variations in hazards or expense provisions or both. Such standards may measure any differences among risks which may have a probable effect upon losses or expenses.

18 Del. C. § 2503(b) states:

> Nothing in this section shall be taken to prohibit as unreasonable or unfairly discriminatory the establishment of classifications or modifications of

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> classifications or risk based upon size, expense, management, individual experience, purpose of insurance location or dispersion of hazard or any other reasonable considerations provided such classifications and modifications apply to all risk under the same or substantially similar circumstances or conditions.

18 Del. C. § 2304(15)c. states:

> No such insurer shall make or permit any unfair discrimination between insureds or property having life 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.

Similarly, 18 Del. C. § 2503(a)(2) specifies that "Rates shall 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.

To the extent that price optimization involves gathering and analyzing data related to numerous characteristics specific to a particular policyholder and unrelated to risk of loss or expense, insurers may not use price optimization to rate policies in Delaware.

The Department does not intend this Bulletin to prohibit or restrict such practices as capping or transitional pricing when applied on a group basis. 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.

Any insurer currently utilizing price optimization in any manner similar to that described above to rate insurance policies in Delaware must submit a SERFF filing that is compliant with this Bulletin no later than December 15, 2015, with proposed effective dates no later than April 1, 2016, for new business and July 1, 2016, for renewal business. The filing submission must identify the SERFF tracking number of the filing that is being replaced or corrected.

Failure to submit the above-described filing in compliance with this Bulletin may result in administrative action.

This Bulletin shall be effective immediately and shall remain in effect unless withdrawn or superseded by subsequent law, regulation or bulletin.

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