



AMERICAN ACADEMY *of* ACTUARIES

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March 14, 2016

Honorable John M. Huff, President
National Association of Insurance Commissioners
Via email

Dear Commissioner Huff:

The Price Optimization Task Force of the American Academy of Actuaries’¹ Casualty Practice Council commends the work of the Casualty Actuarial and Statistical Task Force (CASTF) in developing the *Price Optimization White Paper*, approved by the Property & Casualty (C) Committee, which is before the Executive Committee and Plenary for adoption. The paper is a significant contribution to informing regulators and the general public on price optimization and the issues that surround it. However, we do wish to raise one concern with the white paper, specifically the final edits to paragraph 48, items (a) and (b) that were made by the CASTF on Nov. 19 just before it was adopted by the Property and Casualty (C) Committee.

Prior to the edits, items 48(a) and 48(b) both contained the qualifier “at an individual or granular level,” a phrase that was removed in the final version. (For convenience, the third page of this letter shows the last two versions of paragraph 48.) Consequently, as adopted, paragraph 48 seems to conclude that any consideration of price elasticity of demand is inconsistent with the statutory requirement that rates not be unfairly discriminatory. Yet, in the paragraph immediately preceding, 47(c), the white paper acknowledges that capping and transitional rules can be in the public’s best interest.

Decisions about capping adjustments are normally based on, or informed by, an insurer’s knowledge of its insureds’ historical response to price increases; i.e., considerations of price elasticity of demand, including the propensity to shop for insurance. By eliminating the qualifier in paragraph 48(a) and (b), it appears that adjustments at the group (or class) level cannot

¹ The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

consider the price sensitivity of that group if that knowledge is obtained through any type of demand analysis.

Based on the discussions at the CASTF (and on the content of both paragraph 47(c) and Appendix B of the white paper), we believe that many members of the CASTF consider these practices to be acceptable, so long as the price elasticity of demand analysis is not based on the individual policyholder characteristics. Therefore, we suggest the following wording (underlined below) in paragraph 48(a) and (b) and the parallel paragraph in Appendix B:

“...
a. consideration of price elasticity of demand based on individual policyholder characteristics;
b. propensity of the individual policyholder to shop for insurance;
...”

These additions clarify that adjustments to the actuarially indicated rate can be determined based on price elasticity considerations at the class or territory level, and applied policy by policy, which is a common current and longstanding practice.

Because the list in paragraph 48 of practices inconsistent with the unfair discrimination requirement is a minimum list, regulators will be free to adopt more stringent definitions, including prohibition of price elasticity considerations even at the class level.

We thank you for your consideration on this matter. If you have any questions or would like to speak further, please contact Senior Casualty Policy Analyst Marc Rosenberg at 202-223-8196 or at rosenberg@actuary.org.

Sincerely,

Shawna Ackerman, MAAA, FCAS
Vice President, Casualty Practice Council

W. James MacGinnitie, MAAA, FCAS, FSA
Senior Property/Casualty Fellow
American Academy of Actuaries

Penultimate Version:

48. The Task Force recommends that under the requirement “rates shall not be ... unfairly discriminatory,” insurance rating practices that adjust the current or actuarially indicated rates or the premiums, whether included or not included in the insurer’s rating plan, should not be allowed when the practice cannot be shown to be cost-based or comply with the state’s rating law. With due consideration as to whether practices are cost-based or in compliance with state rating law, the Task Force recommends that, at a minimum, adjustments to rates or premiums based on the following be prohibited:

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

*For this purpose, the Task Force recommends that states interpret a “granular” level to exist when an insurance company groups policyholders into sparsely populated classes and makes pricing decisions for individual classes or a group of classes that lack credibility.

As adopted:

48. The Task Force recommends that under the requirement “rates shall not be ... unfairly discriminatory,” insurance rating practices that adjust the current or actuarially indicated rates or the premiums, whether included or not included in the insurer’s rating plan, should not be allowed when the practice cannot be shown to be cost-based or comply with the state’s rating law. With due consideration as to whether practices are cost-based or in compliance with state rating law, the Task Force believes the following practices~~recommends that~~, at a minimum,~~adjustments to rates or premiums based on the following be prohibited~~ are inconsistent with statutory requirements that “rates shall not be ... unfairly discriminatory”:

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

~~*For this purpose, the Task Force recommends that states interpret a “granular” level to exist when an insurance company groups policyholders into sparsely populated classes and makes pricing decisions for individual classes or a group of classes that lack credibility.~~