STATE OF MAINE
DEPARTMENT OF PROFESSIONAL
AND FINANCIAL REGULATION
BUREAU OF INSURANCE
34 STATE HOUSE STATION
AUGUSTA, MAINE
04333-0034

Paul R. LePage
GOVERNOR

Eric A. Cioppa
Superintendent

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Price Optimization and Elasticity of Demand

The Superintendent of Insurance directs this Bulletin to insurers required to file rates for personal lines property and casualty insurance in Maine. It has come to the Superintendent's attention that some insurers' rates include factors, unrelated to underwriting, that consider the point at which a policyholder will look for coverage elsewhere because of increases in the premium charged. Their ratemaking methodologies make use of data analysis techniques that have been developed to test the willingness of individual customers to pay higher rates for coverage than other customers with similar underwriting characteristics. Common terms used in describing this practice are "price optimization" and "elasticity of demand."

This Bulletin reminds insurers that their rates must comply with several important provisions of Maine law:

- First, rates "shall not be excessive, inadequate or unfairly discriminatory."[1]
- Second, in making rates, insurers must give "due consideration" to, among other factors, past and prospective loss experience; fire and catastrophe hazards; reasonable margins for underwriting profit and contingencies; dividends, savings or unabsorbed premium deposits allowed or returned by insurers to policyholders, members or subscribers; past and prospective expenses; and other relevant factors.[2]
- Third, each "insurer shall file with the superintendent … every manual rate, minimum premium, class rate, rating schedule or rating plan and every other rating rule, and every modification of any of the foregoing that it proposes to use."[3]
- Fourth, no property or casualty insurer "shall make or permit any 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."[4]

[1] 24-A M.R.S. § 2303(1)(B)

[2] 24-A M.R.S. § 2303(1)(C)

[3] 24-A M.R.S. § 2304-A(1)

[4] 24-A M.R.S. § 2162(2)

These statutes evidence a clear purpose in Maine that insurers classify risks according to actuarially supported considerations grounded in insurance loss and expense and disclose those considerations fully in their rate filings. Failure to do so puts insurers at high risk of violating Maine rating law.

The Superintendent does not intend this Bulletin to prohibit or restrict such practices as capping or transitional pricing if applied on a group basis. Insurers should group individual policyholders into credible 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 Maine's rating laws as long as the classifications are based strictly on risk of loss and not on willingness to pay or "elasticity of demand."

Any insurer that uses price optimization to rate policies delivered or issued for delivery in Maine should submit revised filings that remove such factors within 60 days after the date of this Bulletin. Insurers must also disclose on the SERFF General Information page whether the company uses non-risk-related factors such as price optimization or elasticity of demand to help determine personal insurance premiums. Insurers with currently pending rate filings should amend them to disclose this information. Companies that fail to do so and are later determined to have used price optimization or elasticity of demand or failed to disclose such use to the Superintendent may be subject to disciplinary action.

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Eric A. Cioppa
Superintendent of Insurance

NOTE: This Bulletin is intended solely for informational purposes. It is not intended to set forth legal rights, duties, or privileges, nor is it intended to provide legal advice. Readers should consult applicable statutes and rules and contact the Bureau of Insurance if additional information is needed.