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Consumer Groups Applaud California Insurance Commissioner Jones for Prohibiting Insurance Companies From Using "Price Optimization" Techniques

California Department of Insurance Says Pricing Insurance Based on Shopping Habits Is Unfair Discrimination and Illegal

Washington, D.C. – California Insurance Commissioner Dave Jones, in a Notice sent today to more than 750 insurance companies, ordered all insurers that use "price optimization" techniques in California to end the practice within six months. He also barred insurance companies from including these pricing practices in any future filings. Price optimization is a technique by which insurance companies estimate or measure the shopping habits of its customers in order to set individual premiums as high as possible regardless of a customer's risk profile.

A copy of the California Department's bulletin and associated news release is available here: http://bit.ly/1DrJxtU

California becomes the nation's third state to explicitly ban this pricing practice, following a Maryland ban ordered in October 2014 and an Ohio ban issued last month. Consumer Federation of America (CFA) and the Center for Economic Justice (CEJ) applauded Commissioner Jones for the decision and called on Insurance Commissioners around the country to follow the lead of California, Maryland, and Ohio.

While California has strict rules on the pricing of auto insurance, premium setting in other lines of insurance such as homeowners coverage has fewer rules. In any line of insurance, though, companies must base rates on risk and today's notice makes it clear that this that the industry has been trying to introduce in recent years violates the principles of fairness that guide insurance pricing.

Over the past several years there has been a growing trend in the insurance industry to use personal consumer data – unrelated to insurance activities – and statistical models to measure how likely each customer is to shop around, how much of a price increase he or she will tolerate and whether there are competitive options for the consumer in the marketplace. After determining what economists call the "price elasticity of demand," insurers push up premiums based on how unlikely it is that a customer will shop around for a better price, even if the policyholder has never caused an accident, been issued a ticket or filed a claim. The models also raise prices unrelated to a consumer's risk of loss based on whether other insurers are actively offering competitive prices in the consumer's micro-location.

"In May of 2013, Commissioner Jones was the first in the nation to warn insurers that price optimization was likely illegal in California. He saw that Americans are required by law to buy auto insurance and by their mortgage company to buy homeowners insurance, and that it is terribly unfair and entirely illegal for insurance companies to vary premiums based on whether or not they are statistically likely to shop around," said J. Robert Hunter, Director of Insurance for Consumer Federation of America and former Texas Insurance Commissioner. "It is the obligation of Insurance Commissioners to protect consumers from this kind of price gouging, which punishes customer loyalty, and we applaud Commissioner Jones for his action."

In December, Consumer Federation of America released an analysis of a new rating structure that Allstate has deployed in at least 15 states, in which that company began using a new rating factor called "marketplace considerations" to price its auto insurance customers. CFA has since called on the Commissioners of those states to reject Allstate's plan and look closely at other companies' rating systems to determine and block other uses of this unfair pricing scheme.

In a series of letters to state insurance commissioners and in presentations to the National Association of Insurance Commissioners over the past two years, Consumer Federation of America and the Center for Economic Justice have called for pro-active and pre-emptive efforts by insurance departments to protect consumers from the use of Big Data and other non-risk related strategies for rating drivers and homeowners and raising prices.

"Price optimization by insurers is Big Data run amok. Consumers are being punished for activities and circumstances without any disclosure or transparency by insurers. The California, Ohio and Maryland actions are the first steps in returning insurance practices to the foundation of pricing insurance based on risk of loss," said Birny Birnbaum, Executive Director of the Center for Economic Justice.

The notice issued by the California Department states the reason for its action today succinctly:

> Price Optimization does not seek to arrive at an actuarially sound estimate of the risk of loss and other future costs of a risk transfer. Therefore, any use of Price Optimization in the ratemaking/pricing process or in a rating plan is unfairly discriminatory in violation of California law.

According to the consumer groups, price optimization marks a radical departure from the actuarial practice of pricing insurance premiums according to the risk of loss posed by the policyholder. The purpose of price optimization is to extract as much profit as possible from policyholders who are often required to purchase insurance policies. CFA and CEJ are reiterating their call on all state insurance departments to follow the lead of these three states and ban the use of price optimization in the insurance market.

It is not clear exactly how many insurers currently use price optimization or similar non-actuarial pricing strategies in the United States. One company that provides price optimization tools, Earnix, has claimed that approximately half of the nation's large property-casualty insurers use price optimization for auto insurance and over one-quarter of large insurers use it for homeowners insurance.

The Consumer Federation of America is a national organization of more than 250 nonprofit consumer groups that was founded in 1968 to advance the consumer interest through research, advocacy, and education.