Consumer Federation of America

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INSURANCE COMMISSIONERS SHOULD BAR INDUSTRY PRACTICE OF RAISING RATES ON CUSTOMERS BASED ON SHOPPING HABITS

Consumer Groups Call Insurer "Price Optimization" Unfair and Discriminatory and Demand an Immediate Ban

Orlando, Florida – At a gathering of the nation's insurance commissioners in Florida, consumer groups called upon regulators to stop insurance companies from using so-called "price optimization" techniques when setting rates and premiums. Price optimization is a data mining tool used by insurers to charge higher premiums to those consumers least likely to shop for a new policy in the face of a rate increase. The groups noted, in a letter sent to commissioners on March 28, 2014, that insurance companies appear to be using these techniques without disclosing that fact to state regulators.

Consumer Federation of America (CFA) and the Center for Economic Justice (CEJ) said that price optimization violates state laws that prohibit insurance companies from unfairly discriminating against customers even though they have the same risk profile as others who are charged lower premiums. The practice also ignores the actuarial requirement that insurance rates are based on risk, the groups wrote.

"Price optimization is a new strategy to overcharge Americans who have to buy auto and home insurance policies," said Bob Hunter, CFA's Director of Insurance and former Texas Insurance Commissioner. "Despite the feigned innocence of the software developers and insurance executives behind these products, the tool is nothing less than an end-around critical consumer protection rules that are needed to ensure fair pricing of insurance products."

The products use "price elasticity of demand" research – which incorporates sophisticated market analyses to determine which customers would be likely to accept price increases and which customers, in the face of an increase, would shop around. This enables companies to predict whether or not they could get away with rates higher on certain groups of customers. The consumer groups noted that low-income customers – who have fewer market options due to geography, time available, and financial literacy, tend to shop less than wealthier consumers. These low-income consumers are the ones most harmed by price optimization.

"This so-called 'price optimization' is the latest effort by insurers to mine personal consumer information and to evade state consumer protection laws prohibiting unfair discrimination in insurance pricing," said Birny Birnbaum, Executive Director of CEJ and former Texas regulator. "Insurers have generally failed to disclose their use of price optimization to insurance regulators."

The letter to Commissioners is a response to a recent presentation to a National Association of Insurance Commissioners auto insurance committee by a data firm (Earnix) that markets price optimization software to insurance companies. The groups point out that in its presentation to the NAIC committee, Earnix changed its description of its software, which it had previously described as a profit maximization tool based on price elasticity of demand. At the March 17, 2014 presentation to regulators, Earnix avoided such descriptions instead downplaying the product as merely a tool to improve management judgment for competitive purposes.

In the letter, CFA and CEJ, detail several misrepresentations made by Earnix to regulators, including:

- hiding the purpose of "price optimization" as something other than maximizing the insurer's ability to charge more;
- hiding the foundational factor of "price optimization" –raising prices for those consumers less likely to shop around in the face of a premium increase; and
- representing "price optimization" as something other than a risk classification based on a factor – price elasticity of demand – unrelated to loss costs or other costs associated with the transfer of risk.

The groups concluded the letter by calling for a prohibition on the use of price optimization software and asked the regulators to focus on the growing use of data mining techniques by insurers which undermines consumer protection laws:

"We urge state insurance regulators to not only stop the use of price optimization, but to develop a modern regulatory framework for insurance risk classifications that recognizes insurers' access to and increasing use of mountains of personal consumer information and protect consumers against unfair discrimination," Birnbaum concluded.

The Center for Economic Justice is a nonprofit Texas corporation advocating on behalf of low-income and minority consumers on credit, insurance and utility matters. www.cej-online.org.