July 31, 2015

Via email to Kris DeFrain (kdefrain@naic.org) and Tiffany Fosgate (fosgate@naic.org)

Richard Piazza
Chair, Casualty Actuarial and Statistical (C) Task Force
c/o Kris DeFrain, Director, Research and Actuarial Department
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RE: Casualty Actuarial and Statistical (C) Task Force Request for Information

Dear Mr. Piazza:

Thank you for the opportunity to provide further input on the Casualty Actuarial and Statistical Task Force (CASTF) “Price Optimization White Paper.” The American Academy of Actuaries¹ Casualty Practice Council (CPC) formed the Price Optimization Task Force earlier this year to specifically focus on the actuarial and public policy issues concerning price optimization. As you begin drafting the final section of the white paper, “Recommendations and Next Steps,” we have some suggestions for recommendations to include in that section.

In our experience,² the current rate statutes and regulations provide state regulators with the ability to stop unfairly discriminatory pricing practices for personal lines’ insurance products regardless of whether the final prices are selected considering price-optimized results, pure judgment, or some other technique.

The white paper is a significant contribution to the understanding of price optimization and the issues that surround it. In particular, the current paragraph 39 provides a robust set of options for regulators to consider. Among them are several that we believe are worthy of elevating to the status of recommendations: specifically, those contained in paragraphs 39c and 39f (ii) – g(i). Depending on a state’s rate filing law (e.g., prior approval, use and file, etc.), these considerations could become part of the rate filing review process.

The draft white paper provides an excellent overview of various definitions of price optimization. However, the absence of a common definition of “price optimization” can create

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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. The Academy assists 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.
² The members of the Task Force do not have experience with rate filings in every state.
confusion, as demonstrated by the fact that the state bulletins issued thus far describe the practice somewhat differently. Some bulletins would appear to prohibit or restrict long-standing practices such as considering competitor rates or considering consumer behavioral response to rate changes because such practices are included in the state’s definition of price optimization. Should agreement on a single definition be unachievable, a common understanding of the elements of price optimization would be helpful, particularly if a state decides to require insurers to disclose whether price optimization is being used. The necessary elements for price optimization are as follows:

1. Model(s) or assumptions to estimate costs
2. Model(s) or assumptions to estimate market conditions (this may include separate models for new business conversion, policyholder retention, competition, etc.)
3. Target business objectives and requirements
4. Constraints (e.g., limiting answers to those that fall between the current price and the cost-based indication)
5. An algorithm that integrates items 1 and 2 in order to achieve item 3 and fulfill item 4

Judgment plays a key role throughout the ratemaking process. Even when price optimization is used, it is used as guidance in making the final rate-setting selections. The final selections should be the focus of the rate review; the ability to use judgment in arriving at final selections is important.

The Academy’s Price Optimization Task Force appreciates this opportunity to provide comments to the CASTF. We hope these observations and suggestions are helpful, and we welcome further discussion. If you have any questions about our comments, please contact Lauren Pachman, the Academy’s casualty policy analyst, at pachman@actuary.org or (202) 223-8196.

Sincerely,

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