Consumer Federation of America

December 16, 2014

Re: Proof that Price Optimization Is Being Used and Producing Unfairly Discriminatory Rates

Dear Commissioner:

We have previously[1] alerted you to the dangers of Price Optimization. We have said that it will be used to produce unfairly discriminatory rates, illegal in every state. We now have proof, in the form of rate filings from several states, that unfair pricing through so-called "optimization" is occurring.

Allstate Property & Casualty Company in Wisconsin made one of the filings that provides this evidence that was effective on December 11, 2013. The file's SERFF tracking number is ALSE-129228482 and it can be downloaded here: http://bit.ly/1B2Ewnk.

We have also reviewed filings from Pennsylvania and Oklahoma that indicate Allstate's use in those states of the same price optimization techniques as in the Wisconsin filing. Further, we have evidence that Allstate has deployed or attempted to deploy this in Illinois, Louisiana, Virginia, Colorado, Missouri, Utah, Iowa, Tennessee, Oregon, Idaho, Arizona, Nebraska, Indiana and Maryland as well.

The 1503 page Wisconsin auto insurance rate and rule filing linked above introduces a new rating factor – the Complementary Group Rating factor – that evaluates policyholders based on three criteria (quoted directly from the filing on page 189):

> *1. Expected loss costs (from the loss model described on Page 1 of Attachment IA)*
> *2. Policyholder disruption*
> *3. Marketplace considerations*

The filing includes a matrix of nearly 100,000 "micro-segments" assigning policyholders to a particular complementary group according to four characteristics: Birthdate of the eldest driver named on the policy, Gender, Years of Prior Insurance and ZIP Code. While Allstate does not disclose its methodology for assessing "Marketplace considerations," we are confident that this is an evaluation

[1] August 29, 2013, March 28, 2014 and an undated letter congratulating Maryland for banning Price Optimization sent on October 31,2014.

of non-risk related factors such as price elasticity of demand and other characteristics related to willingness to pay higher than actuarially sound rates.

Here is an example of the unfairly discriminatory impact of this new pricing scheme:

> A male driver with a perfect driving record, who had been with his previous auto insurance company for more than five years, lives in Mequon, Wisconsin (53092) and was born on January 12, 1968 *pays 29.5% more than the exact same driver* would if he were instead born three months later on April 9, 1968.

A perusal of the rate filing's tables reveals innumerable examples of drivers who are otherwise exactly the same, paying different rates ostensibly attributable to the day of the year on which they were born and any "marketplace considerations" associated with the customer born on that date.

To facilitate a quick review of this startling new filing, we suggest you focus on the following items (all pages refer to the PDF page number rather):

1. The filing's description of "RULE 79 – COMPLEMENTARY GROUP RATING" (page 25);
2. Premium Calculation (page 28), which incorporates the new "Complementary Group Rating Factor" as the final multiplicative factor (step number 40) in the insurer's premium calculation;
3. Rule 79 - COMPLEMENTARY GROUP RATING (CGR) FACTOR – (pages 30-45), which lists approximately 1,000 different "complementary groups," of which approximately 900 appear to have unique rating relativities ranging from 0.1066 to 9.3823;
4. Attachment IA (particularly page 180 and 181), which discusses the use of Generalized Linear Models and the new loss model's interaction with CGR;
5. Allstate's introductory letter describing the new CGR (page 186);
6. Allstate's description of the components of the complementary group assignment structure (page 189); and
7. Attachment VI (page 191-1503) showing nearly one hundred thousand micro-segments and the complementary group assignment for each. [2]

Here is what CFA has determined is going on in this filing (and the many similar filings throughout the country):

- Allstate first introduces a new Generalized Linear Model "which is significantly more predictive of expected loss costs." (See Attachment 1A, Page 1 in filing)
- At the same time, Allstate introduces its Complementary Group Rating Plan (CGRP). This is not part of the risk-based loss cost model but, rather, a rating

[2] See Exhibit VI, with more than 1,300 pages of about 75 micro-segments per page.

superstructure into which Allstate incorporates the new loss model *and* other non-risk-based characteristics. (See Attachment 1A, Page2)

- Under CGRP, each policy is assigned to a "micro-segment." There are, in fact, more micro-segments in Wisconsin than policyholders served by this Allstate company. It is very possible that each of Allstate Property and Casualty Insurance Company's Wisconsin policyholders resides in his or her own micro-segment.[3]
- Each micro-segment is placed into one of one thousand Complementary Groups based on certain criteria – expected loss costs, policyholder disruption and market considerations – that are not further explained.
- This Complementary Group serves as a new rating factor. Each Complementary Group has a rating relativity ranging from a low of 0.1066 to a high of 9.3823(so the high factor is nearly 9000% higher than the low factor). This factor is applied as Step 40 in the "Premium Calculation" and, importantly, is applied <u>after</u> all risk factors are applied. Though clearly a rating factor, Complementary Group is, explicitly, not a risk factor.

As noted above, we believe that elasticity of demand is introduced through the "market considerations" criterion, as are caps on large rate swings through the disruption criterion. Although, the model used for price elasticity is not shown in the filing, a regulator could obtain it during the rate application process, a market conduct exam, or at any time by order of the Commissioner.

The filing shows what we have alleged throughout the ongoing debate over Price Optimization: that insurers are unable to resist the temptation to use Price Optimization to break up risk classes and base prices on non-risk related factors such as price elasticity. We highly doubt that Allstate is the only company using these illegal techniques, though we do not know if other insurers are as brazen in their deployment of price optimization as Allstate. Other insurers appear to have developed other ways of price-optimizing: increasing the relativities for the characteristic correlated with low elasticity of demand, or possibly basing tiering and running mate placement of risks on non-risk characteristics. Such methodologies thus incorporate elasticity of demand surreptitiously rather than through the explicit rating factor approach Allstate is now using in Wisconsin and other states. Regardless of how it is done—whether through an explicit rating factor or through more hidden means--CFA believes price optimization will always result in unfairly discriminatory pricing that is illegal everywhere.

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[3] In its Pennsylvania filings introducing these concepts, Allstate acknowledges that only about 1,800 of the company's 300,000 policyholders (less than 1%) do not have their own unique micro-segment. In fact, in that state, Allstate has so many potential micro-segments that it needed to condense its micro-segment disclosure. Otherwise, "there would have been over 200,000,000 additional micro-segments listed, which would represent over 2,000,000 additional pages with each filing." (Attachment VII, Page 1).

We urge you to determine if Allstate has made a filing similar to this in your state and to immediately start action to disapprove such filing or order that it be rescinded if it is already in place. We ask specifically that if such a filing exists in your state that you immediately obtain and analyze the model used by Allstate to introduce "Marketplace Considerations" into pricing. Further, we urge you to adopt the bulletin introduced by the Maryland Insurance Administration that requires all insurers that use price optimization techniques to acknowledge so and develop a plan and timeline for revising their rating system to remove such techniques. Finally, we ask that you conduct a public hearing on the issue of Price Optimization and order insurance companies to testify as to their own use of Optimization techniques.

Sincerely,

J. Robert Hunter

J. Robert Hunter
Director of Insurance

cc: NAIC CASTF
NAIC Auto Insurance (C/D) Study Group
Michael McRaith, Director of FIO