Price Optimization

INSURANCE RATING Q&A

SHARE THIS

DOWNLOAD TO PDF

Q. What is price optimization?

A. Price optimization refers to a process or technique used in many industries to help determine what a company will charge for its product or service. In insurance, this process helps insurers fine-tune the premium it will charge for a policy.

Q. Is there anything wrong or inappropriate with the use of price optimization?

A. No. Non-insurance firms have long employed price optimization techniques to help them determine prices consistent with a wide variety of strategic goals and objectives. In this era of “Big Data,” non-insurance firms now routinely employ sophisticated computer algorithms to help determine pricing structures. Outside of insurance, price optimization is common and uncontroversial.

Insurance companies employ actuaries who use actual loss and expense data to estimate a range of reasonable rates and, within those boundaries, management determines the final rates will be charged. Some insurers have begun to use sophisticated optimization models to help them ascertain appropriate pricing.

Q. How many insurance companies are using these sophisticated models?

A. Most insurance companies do *not* use this tool. In fact, a 2013 Towers Watson survey showed that only 12 percent of insurers are using price optimization for personal lines like auto insurance.

Q. Who is voicing concern over the issue?

A. One consumer group has asserted, without offering any evidence to support its claim, that these sophisticated computer models may hurt lower income drivers. This group has alleged that low income shoppers are the least savvy and that the models will lead to their being charged higher rates—whereas, in fact, a 2014 Insurance Information Institute survey found that persons making less than $35,000 a year were more likely to shop around for a policy than people at any other income level.

Insurers note that rates are based on risk as determined by actual claim experience and many other risk-based factors such type of driving record, vehicle driven, location, age and gender.

The reality is that the auto insurance market is extremely competitive. Any insurer that systematically attempted to overcharge consumers would lose market share as consumers shop around for less expensive coverage.

Q. What do insurance regulators think?

A. Most regulators are studying the issue carefully. The National Association of Insurance Commissioners has its Casualty Actuarial and Statistical Task Force developing a white paper on the topic. Four states—Florida, Maryland, Ohio and California—have banned the use of, in the words of Ohio’s Department of Insurance, “varying premiums based upon factors unrelated to the risk of loss in order to charge each insured the highest price that the market will bear.”

Q. Do consumers care about this?

A. The short answer is, no. Few, if any, complaints have arisen from the insurance-buying public. Consumers ultimately care about how much they are paying for insurance and whether they like the product and service. Consumers who are not happy with their auto insurance carrier know that they can voice their displeasure with their wallet by finding another insurance company.

Auto insurance is a highly competitive, highly regulated business. The vast majority of drivers have a large number of insurance companies to choose from—and shopping for insurance has never been easier. Auto insurance ads are ubiquitous, appearing with great frequency in every advertising medium.

For more information about how to shop for auto insurance, consumers can visit the Insurance Information Institute's website at www.iii.org.

Back to top