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January 31, 2015

Via email to [comments@actuary.org](mailto:comments@actuary.org)

Actuarial Standards Board (ASB)  
1850 M Street, NW, Suite 300  
Washington, DC 20036

RE: Exposure Draft of Actuarial Standard of Practice on Property/Casualty Ratemaking

Thank you for the opportunity to provide comments on the proposed Actuarial Standard of Practice (ASOP), *Property/Casualty Ratemaking*. The American Academy of Actuaries<sup>1</sup> Casualty Practice Council (CPC) has reviewed the document and offers the comments below. As you know, the CPC is comprised of actuaries with diverse experiences and opinions; the suggestions and edits that follow represent the view of the majority of CPC members.

### **Preamble**

In our comments to the Casualty Actuarial Society (CAS) regarding its *Discussion Draft: CAS Statement of Principles Regarding Property and Casualty Insurance Ratemaking* (CAS SOP), which are attached here for your information, we have encouraged the CAS to incorporate an introduction or preamble to the Statement of Principles that would more fully address the role and intent of that document in the context of related ASOPs.

### **Scope**

We encourage the ASB to give serious consideration to limiting the scope of this ASOP to regulatory filings for property and casualty ratemaking. Absent such a limitation, as presently written, this ASOP does not sufficiently address or give adequate guidance for the many other types of insurance and alternative risk transfer mechanisms to which it would apply. Initially creating a more focused ratemaking ASOP would also be consistent with the evolution of ASOP Nos. 36 and 43, where first, the specific need for guidance on Statements of Actuarial Opinion on Loss Reserves for regulatory purposes was addressed, followed by the development of a separate ASOP covering the broader subject of developing unpaid claims estimates.

Limiting the scope of this ASOP as we suggest would require changes to Sections 1.2, 2.7, and 2.9 of the exposure draft. Possible language revisions for those parts of the exposure draft are suggested below:

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<sup>1</sup> The American Academy of Actuaries is an 18,000+ 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.

1.2 Scope — This standard applies to all actuaries when performing professional services with respect to developing, reviewing, or changing regulatory filings for property/casualty insurance rates for policies not yet written. ~~This includes the evaluation of future costs for self insurance, risk funding or retention mechanisms, or any other risk transfer mechanism.~~ Such professional services may include expert testimony, regulatory activities, legislative activities, or statements concerning public policy to the extent these activities involve developing, reviewing, or changing regulatory filings for property/casualty insurance rates. ~~This standard is limited to the estimation of future costs and does not address other considerations that may affect the price charged to the policyholder, such as marketing goals, competition, and legal restrictions.~~

2.7 Policyholder — ~~An individual or entity~~ Individuals or entities that pays a premium for an insurance policy ~~or share in the funding of the costs of self insurance, risk funding or retention mechanisms, or any other risk transfer mechanism for policies not yet written.~~

2.9 Ratemaking — The process of estimating future costs associated with the transfer of risk in insurance ~~or other risk transfer mechanisms.~~

We also note that the current ASOP No. 8, *Regulatory Filings for Health Plan Benefits, Accident and Health Insurance, and Entities Providing Health Benefits* provides an excellent template for developing an ASOP intended to provide guidance for property/casualty regulatory filings.

## **Regulatory Standards or Benchmarks**

In our comments to the CAS regarding the CAS SOP, we have suggested removing certain portions of the CAS SOP that relate to regulatory criteria, because we believe that they are more appropriately addressed by ASOPs. Consistent with that belief, we recommend adding a section on the relationship between ASOPs and regulations to the exposure draft (regardless of whether our recommendation of a limited scope is accepted.) Borrowing from the wording in Sections 3.3 and 3.11 of ASOP No. 8, we suggest new sections 3.18 and 3.19 as follows:

3.18 Applicable Law – When an actuary prepares or reviews a regulatory filing, the actuary should have knowledge and understanding of applicable law. If the actuary believes applicable law is silent or ambiguous on a relevant issue, the actuary should consider obtaining guidance from an appropriate expert. In this situation, the actuary should document how the relevant issue was addressed when preparing or reviewing the filing.

3.19 Regulatory Benchmark – The actuary may be called upon to project results in relation to a regulatory benchmark. The actuary should base the projection on appropriate available information about the relevant book of business.

Where regulatory benchmarks exist, they might include but are not limited to the following:

3.19.1 Rate Adequacy—Rates may be considered adequate if they provide for all costs associated with the transfer of risk.

3.19.2 Rates Not Excessive—Rates may be considered excessive if they exceed the amount needed to provide for all costs associated with the transfer of risk.

3.19.3 Rates Not Unfairly Discriminatory—Rates may be considered unfairly discriminatory if the rates result in premium differences among insureds within

similar risk categories that: (1) are not permissible under applicable law; or (2) in the absence of an applicable law, do not reasonably correspond to differences in estimated costs.

Regulatory benchmarks might also be triggered only in the absence of a competitive market where the rates would apply (the determination of which is beyond the scope of this ASOP).

As noted above, we recommend that the phrase “legal restrictions” be stricken from Section 1.2 – Scope. The relationship between this ASOP and applicable regulations should be discussed in a new section entitled “Applicable Law.” We also note that ASOP No. 12, Section 3.3.3 specifically addresses consideration of applicable law when establishing risk classes.

### **Intended Measure**

Consistent with our comments to the CAS, we believe that the concept of an intended measure is also applicable to the ratemaking process. It is important because terms like “expected value” and “expected cost” are not sufficiently specific to provide readers with a common understanding. Moreover, an “expected value” estimate may differ for different types of insurance. For example, for typical personal lines insurance it might be useful to use a measure of the mean for the risk transfer cost estimate, whereas a captive insurer of commercial lines might estimate risk transfer costs using a specified percentile confidence interval in excess of the expected value or mean of the loss distribution. Our suggested edits are as follows:

2.8 Rate - An estimate of risk transfer costs, consistent with an intended measure of ~~the expected value~~ of all future costs associated with an individual risk transfer.

3.4 Methods, Models, and Assumptions—The actuary should select appropriate **methods** and **models** for estimating the ~~expected~~ future cost of the components, consistent with the intended measure, that make up the **rate**. ...

3.7, 3.7.2, 3.10 – Delete the word “expected” before “future costs” wherever it appears.

### **Recommended Additions:**

Under “Section 2. Definitions”:

(2.x) Rate Filing – A required regulatory filing for property and casualty insurance, and entities providing coverage for property and casualty risks.

Rate filings may include but are not limited to the following:

- a. filings of manual rates, base rates, rating factors, or underwriting manuals;
- b. filings of rating methodology, as for experience rating formulas and factors;
- c. statements of actuarial soundness or rate adequacy, as may be defined by the applicable regulatory body, for future rating periods; and
- d. other filings of a similar nature as may be required by an applicable regulatory body.

(2.x) Reviewing Actuary—An actuary who is responsible for reviewing a rate filing on behalf of a government agency or consumers. This includes actuaries employed by the government agency and consulting actuaries engaged to review a rate filing on behalf of the government agency or consumers.

## Additional Suggestions

Section 2.10 – We propose the following revision:

Schedule Rating—A rate modification technique that considers the individual risk characteristics that are expected to affect the **policyholder’s** future loss and allocated loss adjustment expense experience but are not yet reflected elsewhere in the ~~experience rating process~~.

Section 3.1 – We propose the following revision:

Introduction—The actuary should identify and consider the costs associated with the components that make up the **rate**. Examples of the types of costs may include but are not limited to such costs as ~~components should include~~ loss and loss adjustment expenses, operational and administrative expenses, ~~profit and contingency provisions,~~ and the cost of capital.

Note: We are making the same request in the CAS SOP.

Section 3.2 – There are more aggregation methods, such as underwriting year and treaty year, than are listed in this section. We suggest adding “but not limited to” prior to the listed examples. (“There are several acceptable aggregation **methods**, including but not limited to . . .”)

Section 3.5 – The exposure base utilized for a particular ratemaking exercise is often a result of historical practice and not a decision that the actuary can change. Therefore, we recommend that Section 3.5 be revised as follows:

Exposure Base—The selection and use of an **exposure base** is a key step in the **ratemaking** process. Often the exposure base is a result of usual and customary practices, making an alternate selection unnecessary or impractical. If the actuary can select an exposure base, ~~The actuary should take into account various practical requirements, in selecting the exposure base,~~ such as that the exposure base ~~it~~ is reasonably related ~~proportional~~ to the estimated loss, as well as objectively measurable and easily verifiable. To the extent these criteria are in conflict, if the actuary selects an exposure base, the actuary should use professional judgment to select the **exposure base** most appropriate for the **ratemaking** exercise.

Section 3.7.1 – Delete the sentence, “This adjustment can be completed either by on-level factors or by means of extension of exposure.” The example adjustment techniques are too limiting.

Section 3.7.3 – While we understand that the listing of adjustments to historical data is not intended to be exhaustive, we recommend adding operational changes to the list, as this is specifically included in the “Considerations” section of the current CAS SOP.

Additional Adjustments to Historical Data—The actuary should consider additional adjustments to the historical data needed to reflect the environment expected to exist in the future period when the **rates** will be in effect. These adjustments include but are not limited to the following:

- a. judicial, legislative, or regulatory changes;
- b. operational changes, including how the coverages are marketed, distributed, underwritten, and managed;
- c. mix of business changes;
- d. policy contract changes;
- e. claim practice changes;
- f. accounting changes; and
- g. reinsurance changes.

As noted above, the CPC is also submitting comments to the CAS regarding the *Discussion Draft: CAS Statement of Principles Regarding Property and Casualty Insurance Ratemaking*, which are attached.

The CPC appreciates this opportunity to provide comments to the ASB. We hope these observations 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](mailto:pachman@actuary.org) or (202) 223-8196.

Sincerely,

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Vice President, Casualty Practice Council  
American Academy of Actuaries

Enclosures