Comment #18 – 4/30/16 -10:56 p.m.

Proposed Actuarial Standard of Practice on Property/Casualty Ratemaking
(Developed by the Ratemaking Task Force of the Casualty Committee of the ASB)

MILLIMAN REVIEW OF SECOND EXPOSURE DRAFT

The following comments are based on a review of the Second Exposure Draft of the Proposed Actuarial Standard of Practice on Property/Casualty Ratemaking by Milliman’s Casualty consultants.

Request for Comments

The ASB requested specific attention to the following questions:

1. Are there any conflicts between the proposed ASOP and existing practice?
   Milliman response: No

2. This standard is proposed to be effective for work “performed on or after” four months following the adoption of the standard. Does this language appear to create any undue burden?
   Milliman response: No

3. Is it clear that this ASOP does not provide any guidance on the use of what is generally referred to as “price optimization,” which relates to the company’s decisions in determining price?
   Milliman response: Yes

4. The task force eliminated the reference to “expected” value of all future costs to eliminate the possible confusion that the only appropriate estimate of all future costs was a mean value without any consideration of potential variability. Is this change appropriate? Does this change lead to confusion about what is being estimated?
   Milliman response: Yes, this change is reasonable. However, we think this change leads to confusion and a lack of clarity about what is being estimated. By removing “expected value” from the estimation of future costs, it seems to allow for other measures of future costs, such as the estimation of the “high estimate” of future costs or the estimation of the “low estimate” of future costs.

5. Is it clear within the definition of ratemaking, section 2.8, that the ASOP provides guidance regarding the estimation of future costs at more refined levels than the aggregate?
   Milliman response: In general, it is clear that the ASOP provides guidance regarding more refined costs than the aggregate. However, in our review of the ASOP, we identified four references to subsets of the rate or costs: Key Issues #3 (page vi), Request for Comments #5 (page vi), Section 1.2 – Scope (page 1), and Section 2.8 – Ratemaking (page 2). Among these four references, three different phrases are used that seem to be referring to the same concept: “subset of the elements of the rate”, “costs at more refined levels than the aggregate”, and “underlying levels that comprise the estimate of the future cost”. To avoid confusion and enhance the clarity of this concept, we recommend that consistent terminology be used in all four of these references.

6. Is it clear that this ASOP applies to elements of the rate, such as loss costs developed by advisory organizations such as ISO, NCCI, and AAIS?
   Milliman response: Yes, but consider clarifying this in section 1.2 by adding loss costs as an example of a subset of the elements of the rate.
Additional Comments

**Section 2.5 (Model)** – The use of the word “phenomenon” seems inappropriate based on the word’s popular usage to describe an extraordinary event. Consider replacing with “real-life situation” or other similar wording.

Note: The word “phenomenon” is also used in section 3.9.b, so if this word is replaced with alternative language, the same change should be made to section 3.9.b.

**Section 3.4 (Methods, Models, and Assumptions)** – The last sentence seems to be unclear. It states that the actuary “should use methods, models, and assumptions that … have no known significant bias to underestimation or overestimation.” That sentence raises the question: bias with respect to what? If an actuary is intentionally making assumptions and selections to produce a rate that is higher than the expected value, is that acceptable or not? Are those selections and assumptions demonstrating a “known significant bias to overestimation”?

ASOP No. 43, *Property/Casualty Unpaid Claim Estimates*, has very similar language (in section 3.6.2), except that it adds the words “of the identified intended measure”. So in ASOP No. 43, if the actuary explicitly states their intended measure is a high estimate, then they should use assumptions that produce a high estimate, and that would not be a “bias to overestimation of the identified intended measure”. But without the concept of intended measure in the proposed Ratemaking ASOP, there seems to be a range of potential interpretations to this section.

**Section 3.6 (Risk Classification System)** – This section directs the actuary to ASOP No. 12, *Risk Classification*. However, neither ASOP No. 12 nor the proposed Ratemaking ASOP mentions that the actuary should consider an off-balance. We recognize that an off-balance is not always needed, but in order to integrate changes to a risk classification system while maintaining overall rate adequacy, an off-balance calculation may be necessary. We recommend adding language that identifies off-balancing as a concept the actuary should consider when making changes to a class system.

**Section 3.7.1 (Use of Historical Exposure and Premium Data)** – This section states that the “actuary should adjust the historical exposure and premium data to reflect a consistent rate and exposure level.” There are numerous analyses where such an adjustment is not necessary, or where an adjustment is needed to either the exposure or premium data, but not both. As a result, we recommend revised wording consistent with what is used in section 3.7.2: “The actuary should consider adjusting the historical exposure and premium data …”

**Section 3.10 (Credibility)** – This section directs the actuary to ASOP No. 25, *Credibility Procedures*, for guidance in considering the credibility given to a particular set of data for ratemaking. We recommend that language be added to this section to clarify that ASOP No. 25 also provides guidance related to selecting a complement of credibility (i.e., relevant experience), which is an equally important aspect within the ratemaking process.

**Section 3.15 (Profit and Contingency Provisions and the Cost of Capital)** – This section directs the actuary to ASOP No. 30, *Treatment of Profit and Contingency Provisions and the Cost of Capital in Property/Casualty Insurance*, for guidance in the consideration of the profit and contingency provisions and the cost of capital for ratemaking. We recommend that language be added to this section to clarify
that ASOP No. 30 also provides guidance related to discounting cash flows to be used in the ratemaking process.