

Title of Exposure Draft: Risk Classification (for All Practice Areas)

Comment Deadline: May 1, 2024

Instructions: Please review the exposure draft, and give the ASB the benefit of your recommendations by completing this comment template. Please fill out the tables within the section below, adding rows as necessary. Sample for completing the template provided at the following link: <http://www.actuarialstandardsboard.org/email/2020/ASB-Comment-Template-Sample.docx>

Each completed comment template received by the comment deadline will receive consideration by the drafting committee and the ASB. The ASB accepts comments by email. Please send to comments@actuary.org and include the phrase 'ASB COMMENTS' in the subject line. Please note: Any email not containing this exact phrase in the subject line will be deleted by our system's spam filter.

The ASB posts all signed comments received to its website to encourage transparency and dialogue. Comments received after the deadline may not be considered. Anonymous comments will not be considered by the ASB nor posted to the website. Comments will be posted in the order that they are received. The ASB disclaims any responsibility for the content of the comments, which are solely the responsibility of those who submit them.

I. Identification:

Name of Commentator / Company

II. ASB Questions (If Any). Responses to any transmittal memorandum questions should be entered below.

Question No.	Commentator Response

III. Specific Recommendations:

Section # (e.g. 3.2.a)	Commentator Recommendation (Please provide recommended wording for any suggested changes)	Commentator Rationale (Support for the recommendation)
2.1	We recommend that this definition be discussed by the task force and revised for clarity.	1. The phrase "The result of actions regarding an element of choice taken by risk subjects" is unclear. 2. This definition appears to lack the key feature of adverse selection: the information asymmetry between the risk subject and the administrator of the financial or personal security system.
2.8	We recommend that this definition be discussed by the task force and revised.	The definition of "unintended bias" doesn't appear to capture the concept of "bias." Rather, this appears to be a definition for "unintended impacts" or "unintended outcomes." This definition would be satisfied if a risk classification system put everyone into the same class, but most would not consider that "unintended bias." With an unclear definition it is unclear what the actuary is supposed to do in Section 3.4.
3.2	Consider adding "A risk classification system assigns each risk to a risk class based on the results of measuring or observing its risk characteristics," which is in the current ASOP No. 12.	The concept of being able to measure or observe the risk characteristics is important. ASOP No. 25 on credibility defines risk characteristics as "Measurable or observable factors or characteristics that are used

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		to assign each risk to one of the risk classes of a risk classification system.”
3.2.6	Consider changing “The actuary should take into account whether the risk characteristics can be objectively determined” back to “The actuary should select risk characteristics that are capable of being objectively determined,” which is the language in the current ASOP No. 12.	The exposure draft appears to weaken the language in the current ASOP. Objectivity is important when selecting risk characteristics.
3.2.6	In the second sentence of this section, when describing what is meant by “objectively determined,” use “and” instead of “or.”	The word “and” should be used because the class should be both 1) based on verifiable facts and 2) not easily manipulated.
3.2.7	Consider making subsections a. and b. their own paragraphs, such that section 3.2 would have 11 paragraphs instead of the current nine.	1. Subsections a. and b. don’t appear related to the concept of practicality. 2. Subsection a. is one of the hallmarks of risk classification and making it a subsection seems to diminish its importance. In addition, we recommend considering adding definitions of credibility and homogeneity given the importance to this work.
4.3	Consider changing this to “Nothing in this standard is intended to require the actuary to disclose confidential information, except where required by statute or regulation. ”	Certain state statutes say that anything associated with or supporting a rate application is subject to public inspection.

IV. General Recommendations (If Any):

Commentator Recommendation (Identify relevant sections when possible)	Commentator Rationale (Support for the recommendation)
Add “Rates within a risk classification system would be considered equitable if differences in rates reflect material differences in expected cost for risk characteristics,” from section 3.2.1 of the current ASOP No. 12.	The current ASOP 12 refers to “expected cost” twice. Both statements about “expected cost” are proposed to be removed from the ASOP completely. Putting this statement back in is helpful for describing one of the key purposes of risk classification.
The current ASOP references risk classification as “the classification of individuals or entities into groups intended to reflect the relative likelihood of expected outcomes” (section 1.2), and the definition of “risk classification system” in section 2.10 states that risks are assigned to groups “based upon the expected cost or benefit of the coverage or services provided.” Consider adding similar language to sections 1.2 or 2.5 of the exposed ASOP.	The exposed ASOP doesn’t appear to state the purpose of risk classification or tie risk classification to expected outcomes. Some information is provided in the background section of the appendix, but it would be helpful if the body of the ASOP referenced why an actuary might want to classify risks into groups. ASOP No. 25 on credibility defines a “risk classification system” as “A system used to assign risks to groups based upon the expected cost or benefit of the coverage or services provided.” This definition, which aligns with that in the current ASOP, seems more useful and practical than the definition of “risk classification framework” in section 2.5 of the exposed ASOP.
Section 3.2.3 is important but would benefit from more clarity.	1. Section 3.2.3 says, “The actuary should have a rational explanation that the relationship between a risk characteristic and a risk measure is not obscure, irrelevant, or arbitrary.” What is an example of an obscure, irrelevant, or arbitrary relationship that nevertheless results in a useful risk predictor?

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	<p>2. Section 3.2.3 says, “Whether it is appropriate to use a risk characteristic may depend on societal, regulatory, and industry practices or may depend on the scope and context of the actuary’s work.”</p> <p>Is this saying there are exceptions where class rates can deviate from expected cost? If so, this may run afoul of state statutes against “unfair discrimination.”</p> <p>Furthermore, is this the actuary’s responsibility or a management decision? If it may be the actuary’s responsibility, we suggest adding “legislative and judicial pressures.”</p>
<p>It appears that the exposure draft has combined sections 3.2.5, 3.2.6, and 3.2.7 of the current ASOP into the second sentence of section 3.2.8. It might be useful to keep these as separate sections and state that the actuary should consider these external influences.</p>	<p>Section 3.2.8 suggests that the actuary needs to consider external influences “that have the potential for material adverse impacts” and then gives examples of external influences. Rather, it’s important to consider these external influences (applicable law and business, government, and industry practices) in every risk classification project, whether or not they could lead to material adverse impacts.</p>
<p>Consider addressing unfair discrimination in the standard.</p>	<p>The draft discusses “unintended bias” but does not mention “unfair discrimination.” “Unfair discrimination” is the language used in many states’ rating statutes. If addressed, the ASOP should state that the definition can vary by state.</p>

V. Signature:

Commentator Signature	Date