

Title of Exposure Draft: ASOP No. 12 Risk Classification

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:

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| Steve Armstrong, on behalf of Allstate Insurance Company actuaries |
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II. ASB Questions (If Any). Responses to any transmittal memorandum questions should be entered below.

| Question No. | Commentator Response |
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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) |
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| 2.1 | We recommend retaining the definition of adverse selection that is in the current version of ASOP 12, as follows: "Actions taken by one party using risk characteristics or other information known to or suspected by that party that cause a financial disadvantage to the financial or personal security system (sometimes referred to as antiselection)." | The proposed definition in the draft does not capture the information imbalance that is an important feature of the current definition. |
| Appendix | Concerning the following quote from the draft: "The actuarial profession has long considered that rates meet those rating laws if the rates are actuarially sound. But understanding the precise meanings of "actuarially sound" and "unfairly discriminatory" requires a more nuanced understanding than a simple definition can convey. Additionally, changing views on social structures and advances in data science and analytics have caused actuaries to re-evaluate | We recommend removing the second sentence because an ASOP should provide guidance on concepts such as "actuarially sound" and "unfair discrimination," rather than stating that they are nuanced. Re-writing the third sentence makes it more straightforward. |

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| | <p>risk classification frameworks for unfair discrimination which may contribute to socially undesirable inequities in products, services, prices, and availability.” We recommend removing the second sentence of the quote and re-writing the third sentence as follows: “Because of changing views on social structures and advances in data science and analytics, actuaries may re-evaluate risk classification frameworks for unfair discrimination that impact protected classes.”</p> | |
| <p>3.2.4</p> | <p>We propose adjusting the wording of the first sentence to remove “assess” and replace it with “consider.”</p> | <p>The adjustment from “should assess” to “should consider” makes the investigation of multivariate effects less prescriptive. In our interpretation, the word assess means the need to complete an analysis to understand the effects. The word “consider” is more general.</p> |
| <p>3.2.7</p> | <p>We recommend one of the two approaches:</p> <ul style="list-style-type: none"> • Include the definition of credibility in Section 2, as is provided in the currently adopted ASOP No. 12. • As part of the explanation in 3.2.7.a, provide a reference to ASOP No. 25 - Credibility Procedures. | <p>The lack of a credibility definition or reference within the ASOP may lead to unintended interpretations because the standard dictionary definition of credibility is broader than what is prescribed in several ASOPs pertaining to credibility.</p> |
| <p>2.8 & 3.4</p> | <p>We propose removing 2.8 and re-writing 3.4 as follows:</p> <p style="text-align: center;">3.4 POTENTIAL FOR UNFAIR DISCRIMINATION AFFECTING PROTECTED CLASSES</p> <p>The actuary may consider the potential for unfair discrimination affecting protected classes as appropriate within the scope of the actuary’s assignment.</p> | <p>These sections need clarification because interpretations of the draft language vary substantially between individuals. Actuaries at the company had various opinions about the intended meaning of sections 2.8 and 3.4. Some actuaries interpreted them to mean that univariate analysis should not be allowed since such analyses might lead to a group of insureds as classified by the risk classification system (the “risk subjects”) being impacted by changes made to rating characteristics that do not define that group. Other actuaries thought that the phrase “specified risk subjects” was a reference to protected classes, and there was also disagreement about whether the phrase “impacts or outcomes” referred to any premium differences or only premium differences that could not be accounted for by differences in insurance costs.</p> <p>These sections also require clarification because their interpretation may be very broad, which could cause unintended consequences. Broad interpretations could be used against insurers in</p> |

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| | | <p>cases litigating impacts on protected classes or any group of insureds. Also, regulators may have broad interpretations of this section. These significant variations in interpretation risk degrading the value and practicality of the ASOP framework.</p> <p>We suggest the following changes, which are reflected in the suggested wording above:</p> <ul style="list-style-type: none">• The term “unintended bias” should not be used because “unintended bias” is commonly synonymous with “unconscious bias,” which refers to actions or behaviors being skewed by stereotypes.• Section 3.4 should not use the word “should.” As defined in ASOP No. 1, “should” indicates “what is normally appropriate practice for an actuary to use when rendering actuarial services.” This definition implies that action must be taken and, depending on the interpretation of what constitutes an appropriate action, the scope could be broad. Even though the words “as appropriate” are included, “as appropriate” is subjective and may be interpreted by some as “never” and by others as “always.” The word “may” should be used instead. As defined in ASOP No. 1, this is analogous to stating that an actuary may use professional judgment.• Section 3.4 should focus on unfair discrimination affecting protected classes. Unfair discrimination is the traditional actuarial and legal standard used in cost-based pricing. Referring to “specific risks subjects” rather than protected classes is too broad and redundant with section 3.2.4 in the draft.• In summary, we would like this section to indicate that an actuary may consider the potential for unfair discrimination affecting protected classes. This is important because many actuaries may |
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| | | consider it taboo to consider protected class information. |
| 3.2.3 | <p>We recommend the following:</p> <ul style="list-style-type: none">• This wording should replace the first paragraph of 3.2.3: “The actuary should be prepared to provide a basis for a connection between a risk characteristic and risk measure which explains that the relationship between the risk characteristic and risk measure is not obscure, irrelevant, or arbitrary; however, the actuary is not required to demonstrate a causal relationship. For example, an actuary could provide an explanation for the relationship that a rational person could accept as possible, refer to common industry practices, or demonstrate a link between the risk characteristic and insured behaviors that are recognized as being linked to insurance costs.”• The last paragraph of section 3.2.3 should be removed. | <p>This section needs clarification. Some actuaries at the company thought the intent was to require the use of rational explanations, while others felt that the intent was to encourage actuaries to think through rational explanations, especially if asked, but not require them to be provided. Also, there was disagreement over what constitutes a “rational explanation.” For instance, some felt this was a low threshold, like the legal interpretation that a rational person could accept the provided explanation as possible. Others felt it meant an intuitive or logical explanation. Some felt that correlation or predictiveness would count as a rational explanation, since they provide statistical support for a connection between the variable and the outcome. There was also concern among the group that legislators, regulators, and actuaries would all interpret this section differently. Without a definition, regulators may interpret a rational explanation to mean an explanation they personally find credible. They might require such explanations for every level of a rating characteristic and every factor selected. It is unlikely that the inclusion of this section will settle any debates on what variables are acceptable to regulators and could accelerate inconsistencies with variable inclusion or exclusion across states and over time.</p> <p>We believe the ASOP should focus on ensuring that risk characteristics are not obscure, irrelevant, or arbitrary since even risk characteristics with loss correlation may be obscure, irrelevant, or arbitrary if the relationship to loss is not well-established over time or across different groups of insureds. There are multiple ways to establish a connection between a risk characteristic and risk measure to ensure that a rating plan is not obscure, irrelevant, or arbitrary. Providing a rational explanation is one way to demonstrate a risk characteristic is not obscure, irrelevant, or arbitrary, though we suggest using the language “an explanation for the relationship that a rational person could accept as possible” to</p> |

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| | | <p>make it clear that the standard should not be based on personal opinion. Other examples are provided in the suggested wording.</p> <p>The last paragraph should be removed, even though it is true, because it is not a standard.</p> |
| 3.5 | <p>We offer the following suggestions for 3.5:</p> <ul style="list-style-type: none">• Exclude section 3.5• Alternatively, modify part b of 3.5 to say “how protected classes are protected under applicable law, if applicable; and” | <p>Most actuaries at the company felt that this section was not necessary since it is redundant with Section 1.2 which states that the actuary should comply with applicable laws, though some did see value in its inclusion since laws concerning protected classes may emerge at a quick pace. Also, note that laws about protected classes in insurance generally do not use or define the phrase “unintended bias” and, as discussed above, we do not recommend the use of this term in the ASOP.</p> |

IV. General Recommendations (If Any):

| Commentator Recommendation (Identify relevant sections when possible) | Commentator Rationale (Support for the recommendation) |
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| Scope of the ASOP | <p>The ASOP as drafted creates ambiguity about which portions of risk classification are in the scope of the ASOP. Generally speaking, risk classification can be categorized into three steps: grouping risk subjects, quantifying the relative difference in risk measure between the risk groups, and evaluating the ultimate result or outcome of the risk classification. It is unclear whether the quantification of the relative difference in risk measure between groups is within the scope of this ASOP. Without understanding the goals of the committee when making these updates, we recommend either clarifying the scope or adding appropriate reference to other ASOPs (e.g., ASOP 53 and 56).</p> |

V. Signature:

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| Commentator Signature | Date |
| Steven D. Armstrong | April 18, 2024 |