

## ASOP 12: Risk Classification

**Comment Deadline: May 1, 2024**

Instructions: Please review the exposure draft, and give the ASB the benefit or 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:

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](mailto: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
Ben Tucker, FCAS, MAAA, Ph.D./ State Farm Mutual Automobile Insurance 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 (Current)	Please consider reinserting the definition of advice, "An actuary's communication or other work product in oral, written, or electronic form setting forth the actuary's professional opinion or recommendations concerning work that falls within the scope of this standard."	This was removed; advice is not defined in ASOP 1 or other ASOP's.
2.5 (Current)	Please consider reinserting the definition of homogeneity, "The degree to which the expected outcomes within a risk class have comparable value."	This was removed; homogeneity is not defined in ASOP 1 or other ASOP's.
2.6 (New)	Please consider adding to the end, "Examples of measurement include: Expected Outcome, Value at Risk, Variance."	This more clearly ties the definition of risk measure to traditional actuarial techniques.
2.8 (New)	Please consider replacing with a clearer definition and discussion; suggested language is below: "Bias in a statistical framework inappropriately preferences specific results. Statistical bias may result from improper selection of a data set, improper data handling/cleaning, improper analysis/modeling of the data, and/or a combination of the above and other methodological errors in data handling and analysis. Systemic bias (bias in large institutions	Unintended bias is defined in a broad manner such that all correlation to anything except the risk subject could be seen as unintended bias. This definition also focuses on the impacts and outcomes rather than the bias which may (or may not) lead to impacts or outcomes. The suggested replacement is intended to be more actionable for the actuary using this guidance.

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	<p>generating data) may cause prospective datasets being reviewed for use by the actuary to be inappropriate for use. Human cognitive bias represents difficulty in identifying and assessing such statistical and systemic biases. Unintended bias is the combination of these biases impacting the results of analyses:</p> <ul style="list-style-type: none"><li>A. Without the knowledge of the analyst:</li><li>B. To an extent which is likely statistically significant.</li><li>C. In a way which may lead to a harmed party.</li></ul>	
3.2.1 (Current)	<p>Please consider reinserting, “The actuary should select risk characteristics that are related to expected outcomes. A relationship between a risk characteristic and an expected outcome, such as cost, is demonstrated if it can be shown that the variation in actual or reasonably anticipated experience correlates to the risk characteristic. In demonstrating a relationship, the actuary may use relevant information from any reliable source, including statistical or other mathematical analysis of available data. The actuary may also use clinical experience and expert opinion.</p> <p>Rates within a risk classification system would be considered equitable if differences in rates reflect material differences in expected cost for risk characteristics. In the context of rates, the word <i>fair</i> is often used in place of the word <i>equitable</i>.</p> <p>The actuary should consider the interdependence of risk characteristics.”</p>	<p>Cost-based pricing is critical to the core responsibility of the actuary in analyzing relationships between risk characteristics in an objective, fair manner. ASOP 12 is the only ASOP which discusses the concept currently. For actuaries in the CAS, we also have the ‘Statement of Ratemaking Principles,’ but SOA actuaries and those of other organizations do not. Socially, the public trust developed by the actuarial community relies on the understanding that their rates are related directly to the risk they present. Legally, the 1945 McCarran-Ferguson Act) provides a limited antitrust exemption from federal law if states regulate insurance based on cost-based pricing. Specifically, McCarran gave insurers 3 years (until June 30, 1948) until certain antitrust laws (Sherman Act, Clayton Act, and Federal Trade Commission Act) would be “applicable to the business of insurance to the extent that such business is not regulated by State law.” The Robinson-Patman Antidiscrimination Act would apply after June 30, 1948. Robinson-Patman prevents price discrimination as an anti-competitive practice: “It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality.” The combination of the Supreme Court ruling in <i>The United States vs. SEUA</i>, the McCarran-Ferguson Act, and the applicability to insurance of the Robinson-Patman Antidiscrimination Act led states to implement cost-based pricing into their insurance laws. States used wording such as: “rates shall not be excessive, inadequate or unfairly discriminatory.” The lack of focus on cost-based pricing in the new ASOP 12 does not reflect the social or legal environment in the actuary’s duty to price customers fairly, that is, on the basis of the risk they present. Finally, if states move away from cost-based pricing, they may find themselves subject to federal insurance regulation through Robinson-Patman, an outcome no one desires.</p>

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3.2.3 (New)	Please consider replacing the first sentence with: “The actuary should consider whether there is a rational explanation between the risk characteristic and risk measure as part of their selection criteria.” Please consider replacing “consistent relationship between risk characteristics and a risk measure” with “relationship between risk characteristic and expected outcome.” Please consider replacing “professional judgment” with “professional judgment along with other actuarial considerations” while adding the sentence, “Professional judgment should be used sparingly with very clear documentation of the reasons.”	The rational explanation test is not especially clear. Whether something is ‘obscure, irrelevant or arbitrary’ may be very subjective. Making this test a requirement rather than a consideration seems unnecessary, given the subjectivity. ‘Consistent relationship’ is not defined here or in other ASOP’s and is not a standard actuarial term; focusing on expected outcome is much clearer. The reference to professional judgment may lead to further disagreement between actuaries about whose actuarial or professional judgment is appropriate; also, this seems to suggest use of professional judgment alone.
3.2.3 (Current)/ 3.2.6 (New)	Please consider changing back to “The actuary should select risk characteristics that are capable of being objectively determined.”	Risk characteristics need to be objectively determinable, so an actuary selecting risk characteristics which are not objective is inappropriate even if they took this “into account.”
3.4 (New)	Please consider replacing with, “The actuary should consider the potential for unintended bias in their work and work on which they are reliant as appropriate within the scope of the actuary’s assignment (e.g., analysis, review, etc.). Unintended bias should be considered in the context of other important actuarial consideration such as relationship with expected outcome.”	This is a broad statement which is very reliant on the definition. It also does not seem very actionable. By tying this to tasks actuaries are already doing, the responsibility is clearer. Unintended bias should also be considered in the context of other actuarial considerations such as the relationship of the risk characteristic with expected outcome.
3.5 (New)	Please consider replacing “follow applicable law” with “review applicable laws” in the first sentence.	The section focuses on following laws pertaining to protected class, but, elsewhere in this (Section 1.2 Paragraph 4, Section 3.2.8) and other ASOPs (ASOP 1 Section 3.1.5), actuaries are told to follow the law. Being aware of and knowledgeable of laws concerning protected class is a clear, actionable requirement.

**IV. General Recommendations (If Any):**

Commentator Recommendation (Identify relevant sections when possible)	Commentator Rationale (Support for the recommendation)
<p>In summary of the Specific Recommendations above, I would suggest the following:</p> <ul style="list-style-type: none"> <li>a. More emphasis on the relationship between risk characteristic and expected cost or expected outcome.</li> <li>b. More clarity about expectations for the actuary (e.g., actionable responsibilities based on this ASOP)</li> <li>c. Keep definitions of terms not in other ASOPs and do not use unclear, subjective terminology without including new definitions.</li> </ul>	<ul style="list-style-type: none"> <li>a. The relationship of risk characteristics to expected cost is foundational to the actuarial profession and belongs in this ASOP.</li> <li>b. Actuaries will likely become confused about their responsibilities if the ASOP is unclear, resulting in unnecessary disagreements which could potentially result in unnecessary ABCD cases; such cases might be difficult to resolve if the underlying ASOP is unclear.</li> <li>c. Definitions and clear accepted terms support clarity (see b.)</li> </ul>

**V. Signature:**

Commentator Signature	Date
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Ben Tucker	04/22/2024
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