

Title of Exposure Draft: ASOP 12; Risk Classification (for All Practice Areas)

Comment Deadline: May 1, 2024

I. Identification:

Name of Commentator / Company
Daniel Lyons, MAAA, FCAS / Retired / I am submitting these comments on my own behalf.

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

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)
1.2 Scope	... or opining on any elements of a risk classification framework ...	Typo I think.
2.6	Risk Gauge Measure —A measurement of the outcomes of a contingent event, <u>to which Risk Subjects are exposed, intended to be mitigated by the financial or personal security system.</u> Examples of risk <u>gauges</u> measures include mortality rates , healthcare costs, and claim frequency, and <u>claim severity</u> .	I think removing “expected” as the sole measure underlying the current ASOP 12 is not appropriate. (See my comments in General Recommendations section below.) Because of the type of examples in this definition I interpret the definition to refer to a kind of a yardstick and suggest replacing “measure” with something else to avoid any interpretation that it could refer to median or mode, etc. If “measure” is dropped references need to change in the rest of the ASOP.
2.8 Unintended Bias	DELETE THIS DEFINITION Unintended Bias—Impacts or outcomes on specific risk subjects resulting from the use of a risk classification framework that is not intentionally designed to result in such impacts or outcomes.	This definition as written is hard to understand and to use. It seems to be contrary to what is written on page 60 of the monograph, <i>On Risk Classification</i> (RCM): “Risk Classification classifies risk, not risk subjects.” A risk classification framework is intentional and the resulting relativities (not covered in this ASOP) are intentional as well so it’s hard to see where something is not intentional. It may be that some do not like the rating relativities but do not object to the risk characteristics used to assign risk subjects to risk classes. For example, a Massachusetts legislator is proposing a law ¹ requiring a 75-25 weighting of

¹ An Act relative to reducing racial and socioeconomic inequities in auto insurance premium pricing

<https://malegislature.gov/Bills/193/S703>

Title of Exposure Draft: ASOP 12; Risk Classification (for All Practice Areas)

Comment Deadline: May 1, 2024

Section # (e.g. 3.2.a)	Commentator Recommendation (Please provide recommended wording for any suggested changes)	Commentator Rationale (Support for the recommendation)
		<p>individual territory indicated loss costs and the state wide average indicated loss cost. The law will also define “unfair discrimination.” As the RCM states, a risk classification system should operate with an awareness of the society in which it operates. Notions of “fairness” will differ within a society and will change over time and it is appropriate for this evolution to be settled through the legislative process. It might be possible that with new algorithms and data, the assignment of risk subjects to risk classes is the result of some sort of “black box” process (i.e., there are no outputs showing which risk characteristics were used (or their weights) in the assignment process). It could also be the case that the underlying training data does not include all types of risk subjects to which the assignment process will be applied. If the Drafting Committee’s concern deals with these two possibilities then perhaps a term and definition can be created. These concerns might also be addressed in ASOP 56 – Modeling.</p> <p>If this definition is deleted then §3.4 (Potential for Unintended Bias) and §3.5 b. (Protected Classes) should be deleted too.</p>

Title of Exposure Draft: ASOP 12; Risk Classification (for All Practice Areas)

Comment Deadline: May 1, 2024

IV. General Recommendations (If Any):

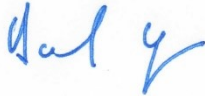
Commentator Recommendation (Identify relevant sections when possible)	Commentator Rationale (Support for the recommendation)
Notable Changes from the Existing ASOP – Point 5	<p>Point 5 on page v states that the general concept of “expected outcome” as used in the current ASOP 12 is being replaced with the term “risk measure”. The draft ASOP does not really expand on why this change is being proposed but Mr. Mullen, in the February 2024 <i>Actuarial Update</i>, is quoted as follows (emphasis added):</p> <p style="text-align: center;">The current ASOP makes numerous references to “expected outcomes.” This could lead an actuary to think primarily only of the expected value, or mean, of the loss distribution. The proposed change to using the term “risk measure” is to reinforce that the actuary may want to consider other aspects of the loss distribution.</p> <p>This is quite a pivot and it would have been appropriate if such a direct explanation was included in the draft ASOP. The current risk classification foundational documents, as I see it, are the <i>Risk Classification Statement of Principles</i> (RCSOP) and the monograph, <i>On Risk Classification</i>² (RCM). “Expected” is used twenty times in the RCSOP, mostly as expected cost (or costs). In the RCM the title of Section II is “Expected Cost” and the title of Section II.E. is “Risk Classification and the Estimation of Expected Cost”. “Expected” is used seventeen times in the current ASOP 12 (excluding appendixes), mostly as expected outcomes. The <i>Statement of Principles Regarding Property and Casualty Insurance Ratemaking</i> (RMSOP) uses “expected” six times, most notably in Principles 1 and 4. The RMSOP also states “Classification Plans – A properly defined classification plan enables the development of actuarially sound rates.” Actuarial sound rates are those determined using Principles 1, 2, and 3.</p> <p>If risk classification is moving away from the concept of expected loss or costs shouldn’t there be updates to the RCSOP, RMSOP, and the RCM first? What is the conceptual framework for such a change? If the ASB moves forward with such a significant change without changing the RCSOP, RMSOP, or RCM doesn’t this create potential problems for the practitioner (inconsistencies between a new ASOP 12 and the RCSOP, RMSOP. or RCM)?</p> <p>I can appreciate that new technologies (AI, machine learning, predictive analytics, etc.) present new challenges so perhaps additional guidance is needed to build out ideas relevant to actuarial practice but extending the underlying concept beyond “expected” does not address these concerns.</p>

² Note that six of the eight proposed definitions in this draft ASOP come from the RCM. 2.6 (Risk Measure) and 2.8 (Unintended Bias) are not in the RCM.

Title of Exposure Draft: ASOP 12; Risk Classification (for All Practice Areas)

Comment Deadline: May 1, 2024

Commentator Recommendation (Identify relevant sections when possible)	Commentator Rationale (Support for the recommendation)
	<p>ASOP 43 (Property/Casualty Unpaid Claim Estimates) states in §3.3 a.1. (SCOPE OF THE UNPAID CLAIM ESTIMATE) states that the actuary should identify the intended measure of the unpaid claim estimate:</p> <p style="padding-left: 40px;">Examples of various types of measures for the unpaid claim estimate include, but are not limited to, high estimate, low estimate, median, mean, mode, actuarial central estimate, mean plus risk margin[,] actuarial central estimate plus risk margin, or specified percentile.</p> <p>But this is used to identify the context within which the unpaid claim estimate was determined. All of the foundational risk classification documents refer to “expected” so I don’t think the ASB can update ASOP 12 as specified in this draft with no one noticing the unexplained significant change.</p>

Commentator Signature	Date
	4-25-2024