

Title of Exposure Draft: Proposed Revision of Actuarial Standard of Practice (ASOP) No. 12

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
Document Review Subcommittee of the CAS Professionalism Education Working Group

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	<p>We find it very difficult to have a simple, concise definition of adverse selection. One comprehensive alternative is the following:</p> <p>"The result of actions regarding an element of choice selections, participation, or other relevant actions taken by individual risk subjects, with attributes not included in the risk classification framework, or with risk characteristics that are included in the risk classification framework but for which the risk classification framework does not accurately reflect the relationship between those risk characteristics and the risk measure, whereby the omission of any such material attributes from the risk classification framework, or the materially inaccurate relationship between those risk characteristics and the risk measure in the risk classification framework which could, in the aggregate, adversely impact the effectiveness ability of a risk classification framework to satisfy its intended purpose or to support the viability of the financial or personal</p>	<ul style="list-style-type: none">• Clarify that adverse selection may occur due to risk subject participation instead of direct actions (e.g., an independent agent moving them to a different insurer for a lower price with the risk subject's consent).• Clarify that actions are taken at the individual risk subject level, not in aggregate.• Clarify that the risk posed by adverse selection is an issue in the aggregate, not necessarily at the individual risk subject level.• Updated definition to make it clear that adverse selection occurs when relevant attributes are either not used as risk characteristics in the risk classification framework, or they are used but not in accordance with the relationship between the attribute and the risk measure. For an example of the latter issue, suppose right-handed individuals cost 20% more to insure

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	<p>security system. Adverse selection is sometimes referred to as “anti-selection.””</p> <p>Add: “For example, adverse selection may occur when the risk classification framework of a financial or personal security system does not consider an attribute that is used in the risk classification frameworks of competing financial or personal security systems. This may cause risk subjects with higher expected costs based on that attribute to be disproportionately selected, thereby increasing the expected costs for the financial or personal security system as a whole.”</p>	<p>on average. If I include a right-handed surcharge in my rating plan but only charge 5% more than average while my competitors are all charging the full 20%, then it is very likely I’ll experience adverse selection, even though I am including that risk characteristic in my risk classification framework.</p> <ul style="list-style-type: none"> • Remove “effectiveness” as that is not clearly defined and instead refer to intended purpose, which is more commonly used in ASOPs. • Clarify spelling of anti-selection. • Add example of adverse selection to make it more understandable.
	<p>Definition of Risk Class: Group versus Continuous</p> <p>Definition: Continuous risk factor: In lieu of grouping into risk classes based on the values of risk characteristics (which corresponded to a step function), the actuary may estimate risk as a function (often but not always continuous) of the risk characteristic(s) in question.</p> <p>This will also require substantive rewording of 2.5 and of 3.2.7(a) as well as surface rewording of 3.2.4.</p> <p>2.5: The system, process, or schema used to assign risk subjects to risk classes, or to assign them to continuous risk factors, based on the risk characteristics of each risk subject.</p> <p>3.2.7(a): the balance among homogeneity within risk classes, heterogeneity between risk classes, and credibility of the individual risk classes; in the case of continuous risk factors, the avoidance of extrapolation, and justification for sharp changes. In all cases, residuals on both in-sample and out-of-sample data should be examined.</p> <p>3.2.4: After “risk class” add “or to the construction of a continuous risk factor”.</p>	<p>This draft standard is not phrased so as to acknowledge that risk characteristics may be treated continuously rather than discretely (as classes) in modern practice. The statistical framework for this has been in place at least since the publication of Hastie and Tibshirani’s <i>Generalized Additive Models</i> in 1990, anticipated by papers by Wahba and others in the 1970s. Indeed, one may view experience modification as a continuous risk factor, in which case the history goes all the way back to the 1910s.</p> <p>Moreover, by focusing on the creation of risk classes, this standard does not align with current practice. Even when current practice still uses risk classes, it often divides them narrowly, into classes that would not be credible on their own, by borrowing strength preferentially from neighboring classes, rather than from the population, in the complement of credibility. Thus the comment in the 3.2.7(a) that the actuary should take into account the credibility of <i>individual</i> risk classes is incomplete.</p>

IV. General Recommendations (If Any):

<p>Commentator Recommendation (Identify relevant sections when possible)</p>
<p>We have some general concerns about this ASOP 12 exposure draft which we discuss below:</p> <ul style="list-style-type: none"> - We have an overarching concern as to whether the ASOP is too abstract and vague to be meaningful or actionable. <ul style="list-style-type: none"> o Because this ASOP intends to cover all the practice areas and potential applications, it has resulted in some too-general language, and may result in it not being relevant to existing actuarial practices as a result. o Actuaries need practical guidance as to implementation – this is too general to provide guidance.

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- We shouldn't have ASOPs setting standards for actuaries in the face of areas of ongoing regulatory changes and potential future research, such as bias and discrimination in insurance, etc.
 - o There are some major points raised in this draft (such as treatment of protected classes in rating) which have significant potential impacts and for which it may be premature to address in an ASOP.

Due to above concerns, the potential avenues we recommend for resolution are as follows:


- Withdraw the exposure draft.
- Develop different ASOPs for Risk Classification and Rating, Risk Classification and Claims, etc. (which may further differ by practice area).

We believe some of these concerns are best handled by the profession developing more non-binding educational material and guidance in the form of practice notes, further paper-writing, and conducting practice-wide education and discussions that address general principles and practical details around risk classification. These venues can better address some of the nuances in this ASOP. Principles and best practices can be discussed, without an attempt to prescribe practices that apply across all practice areas and applications.

P&C ratemaking has a long history of requiring that rates not be excessive, inadequate, or unfairly discriminatory. The suggested wording related to bias in the draft ASOP doesn't address this requirement.

As noted in the points above, our group feels additional time for presentations and open public discussions with members of the ASB or the ASB drafting task force would be very helpful. For the sake of time and brevity, we only included commentary on some of the key issues we saw, but the comments we are submitting fall short of many additional concerns we see with this exposure draft. Members of our group would find it very valuable if the ASB would provide a forum for open conversations, and other opportunities for input, regarding this exposure draft and the objectives of the changes proposed from the current standard. We note that the ASB's rationale for several key changes in the exposure draft from the current ASOP 12 were not fully explained. We also feel there are other items important to the use of this standard which we think need to be addressed.

V. Signature:

Commentator Signature	Date
Signed on behalf of the members of the Document Review Subcommittee of the CAS Professionalism Education Working Group who were involved in this review, Ginda Fisher, Bob Miccolis, Chris Monsour, Josh Taub and Esther Becker 	April 27, 2024