

Title of Exposure Draft: Proposed Revision of 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:

Name of Commentator / Company
David McMichael, FCAS, MAAA on behalf of Travelers Insurance Companies actuaries

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)
1.2 Scope	Consider incorporating verbiage from the current version of the ASOP: “This standard applies ... with respect to ... classification of individuals or entities into groups intended to reflect the relative likelihood of expected outcomes.”	The relationship between a risk class and the expected outcome (risk measure) is a key feature of risk classification frameworks. We recommend retaining this explicit connection in the Scope section of the standard.
	Clarify how the carve-out for nondiscrimination testing should be understood.	It is not clear if the carve-out is intended to cover the ERISA rule for qualified retirement plans, or whether it has other meanings in this context.
2.1 Adverse Selection	Consider reverting to the definition found in the current version of the ASOP.	Adverse selection can result from the actions, inactions, or decisions of parties other than the risk subjects.
2.3 Risk Characteristics	Consider revising to read: “Attributes Measurable or observable factors or characteristics that are used to assign risk subjects to one of the risk classes of a risk classification framework.”	The proposed definition removes the qualifying phrase “measurable or observable” found in the current ASOP. This omission appears to allow the use of characteristics leading to subjective assignment of risk subjects to their risk class.

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2.4 Risk Class	Consider revising to read: “A group set of risk subjects grouped together under a risk classification framework based on risk characteristics.”	Grammatical suggestion to increase clarity.
2.8 Unintended Bias	Consider deleting or revising this definition.	<p>The proposed definition is subjective as it apparently depends upon the intention of the designer, which would be difficult to determine in many cases.</p> <p>If not removed, providing examples of “unintended bias” would be helpful.</p> <p>It is also unclear why other forms of bias are not also addressed.</p>
3.2.3 Relationship of Risk Characteristics and the Risk Measure	<p>Consider clarifying or removing the reference to “rational explanation.”</p> <p>Consider retaining the consideration of the current ASOP that an 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.”</p> <p>Consider deleting or revising the language regarding demonstration of a “consistent relationship between risk characteristics and a risk measure.”</p>	<p>If retained, this term should be defined. For example, it is unclear if demonstration of a statistical relationship between a risk characteristic and the risk measure constitutes a “rational explanation.”</p> <p>This clear language should be retained, since the relationship between risk characteristics and expected outcomes is fundamental to risk classification.</p> <p>If this wording regarding a “consistent relationship” is not removed, it should be revised to avoid potential conflict with the guidance in section 3.2.4 to take into account multivariate effects. When there is a multivariate interaction between risk characteristics and the risk measure, by definition there is not a “consistent relationship” between them.</p>
3.2.8 External Environment	Consider adding “current economic conditions” to the list of external influences.	
3.4 Potential for Unintended Bias	Consider deleting this section.	<p>Guidance regarding the treatment of unintended bias as applicable by law is already given in Section 3.5.2</p> <p>This section should be deleted if definition 2.8 of “unintended bias” is deleted.</p> <p>If not deleted, consider expanding this consideration to include additional forms of bias. Providing definitions or examples of the various forms of bias that should be considered would be helpful.</p>
4.1.5 Required Disclosures in an Actuarial Report / adverse selection	Consider inserting the qualifying phrase “to the extent it can be detected” regarding the impact of significant adverse selection.	Adverse selection often arises when a classification system omits important risk characteristics. Detecting the impact of an omission is often difficult in advance of observing the outcomes over time, since the omitted characteristics are often not present on the historical data available to the actuary.

IV. General Recommendations (If Any):

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<p>Consider retaining the language of the current ASOP (current Section 3.2.1) that describes rates as “equitable” or “fair” if they reflect material differences in expected cost.</p>	<p>Cost based pricing is a fundamental principle of risk classification systems in the context of ratemaking. The current standard provides useful guidance for actuaries on how to comply with the “unfairly discriminatory” provision regarding rates in many states’ statutes. The discussion of this topic as it appears in the current standard should not be removed without careful consideration of the impacts its removal would have on the ratemaking process.</p>
<p>Consider retaining language in the current standard that explicitly mentions that a consideration in the selection of risk characteristics is their relationship with the expected outcomes (“risk measures”).</p>	<p>This consideration is fundamental to risk classification.</p>

V. Signature:

Commentator Signature	Date
David McMichael	April 29, 2024