

May 1, 2024

Mr. Kevin M. Dyke, Chairperson, MAAA, FCAS
Actuarial Standards Board
1850 M St. NW, Suite 300
Washington, DC 20036
Via e-mail: comments@actuary.org

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

Dear Chairman Dyke and members of the Actuarial Standards Board (ASB):

On behalf of the National Association of Mutual Insurance Companies (NAMIC),¹ thank you for the opportunity to provide comments on the exposure draft proposed revisions to ASOP No. 12: “*Risk Classification (for All Practice Areas)*.” NAMIC understands the importance of maintaining a positive relationship with the American Academy of Actuaries and the ASB, and we are grateful for the critical contributions that your member actuaries make to the successful operation of our nearly 1,500 member companies.

We are concerned that the exposure draft of ASOP No. 12 needlessly detracts from the core insurance principle of matching rate to risk. The removal of several passages from the current ASOP No. 12 that reinforce the connection between rates and expected outcomes or costs appears to create significant ambiguity in the proposed principle. The proposed deletions become even more problematic when combined with the introduction of the new term “unintended bias” in Section 2.8 – a standard not found anywhere in state insurance codes that taken to its logical conclusion could even be interpreted to mean charging equal rates to all risks instead of actuarially sound rating plans. We strongly recommend removing Section 2.8, as well as the new Section 3.5; these sections

¹ NAMIC consists of nearly 1,500 member companies, including seven of the top 10 property/casualty insurers in the United States. The association supports regional and local mutual insurance companies on main streets across America and many of the country’s largest national insurers. NAMIC member companies write \$391 billion in annual premiums. Our members account for 68 percent of homeowners, 56 percent of automobile, and 31 percent of the business insurance markets. Through our advocacy programs we promote public policy solutions that benefit NAMIC member companies and the policyholders they serve and foster greater understanding and recognition of the unique alignment of interests between management and policyholders of mutual companies.



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not only lack any ties to expected outcomes or risk measures, but also create the potential for confusion and conflict with Section 1.2 that states the actuary should comply with applicable laws.

We are further concerned that the exposure draft creates ambiguity about which portions of risk classification are within the scope of the ASOP. Generally speaking, risk classification can be categorized into three separate steps: (1) grouping risk subjects; (2) quantifying the relative difference in risk measures between the risk groups; and (3) 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 clarifying the scope or adding appropriate references to other ASOPs (e.g. 53 and 56).

With that in mind, we have completed the attached comment template as requested to include specific recommendations and justifications regarding each part of the proposed disclosure documents and processes. We also note that it is as a result of the highly competitive and innovative marketplace that insurers have developed complex and composite rating plans that ultimately serve to reduce costs for consumers. These plans, designed and validated by actuaries, are what enable competition and improve the accuracy of risk-based pricing to the benefit of policyholders.

We believe strongly that the entire insurance ecosystem is better off when actuaries, insurers, policymakers, and regulators have a better and more consistent understanding of proper and accurate risk classification, which is among the most important features of insurance. We encourage the ASB and its members to work collaboratively with us and other stakeholders considering similar issues. We believe that insurers' interests in helping ensure that consumers are treated fairly are aligned with the ASB, but we do not believe the current proposal strikes the correct balance between law and aspirations.

NAMIC is committed to productive engagement on these topics of great consequence to our members, their actuarial staffs, and ultimately, their policyholders; we look forward to providing additional feedback at appropriate times and venues. Given the significance and complexity of the proposed revisions, we encourage the ASB to hold a public hearing on the draft exposure as contemplated by Section V.E. of the ASB Procedures Manual.² We look forward to continued conversations about this matter and the ASB's other important ongoing efforts.

² <https://www.actuarialstandardsboard.org/wp-content/uploads/2017/06/ASB-Procedures-Manual-doc-187.pdf>



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Sincerely,

A handwritten signature in black ink that reads "Anthony G. Cotto". The signature is written in a cursive style with a large initial 'A'.

Anthony G. Cotto, Esq.

Director of Auto and Underwriting Policy

Title of Exposure Draft: ASOP No. 12: Risk Classification (for All Practice Areas)

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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
Anthony G. Cotto, Esq., Director of Auto and Underwriting Policy / National Association of Mutual Insurance Companies

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	Reverse moving Paragraph 3 to Appendix.	Removal of the section outlining the interdependence of risk classification with other actuarial activities creates the impression that risk classification is a separate exercise, which it is not. The paragraph is more appropriately left in the discussion of the scope of the standard.
Current 2.1	Reverse deletion of definition of "advice."	Removing the definition of advice could lead to different interpretations of what "advice" means, particularly because the term is not defined in ASOP 1. It is important that actuaries retain the ability to provide advice with respect to risk classification systems.
2.1	Recommend retaining the definition of adverse selection that is in the current version of ASOP 12. "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 does not adequately capture the information imbalance that is an important feature of the current definition. Additional comments regarding adverse selection appear below.
2.5	Reverse deletion of definition of "homogeneity"	Removing the definition of homogeneity could lead to different interpretations of what "homogeneity" means, particularly because the term is not defined in ASOP 25.

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2.6	Recommend deletion of new definition of “risk measure.”	This proposed definition appears to be interested in outcomes rather than expected costs or expected outcomes, which are the more appropriate concepts belonging in a standard.
2.8 and 3.4	<p>Recommend deletion of new definition of “unintended bias.”</p> <p>Recommend deletion of new section regarding “potential for unintended bias.” Alternatively, rewrite 3.4 as follows: “The actuary may consider the potential for unfair discrimination affecting protected classes as appropriate within the scope of the actuary’s assignment.”</p>	<p>This proposed definition is not the legal standard found in any state insurance code – that standard is one of unfair discrimination.</p> <p>The proposed definition not only lacks a clear tie to expected outcomes, but even suggests that from a statistical perspective, all correlation to anything except the specific risk subject could be considered unintended bias. Continuing that analysis – all insurance rating plans could be said to have unintended bias unless they charge equal rates to all risks – this is contrary to the foundation of risk-based pricing in insurance.</p> <p>The interpretations of the draft language for these two sections will vary substantially between individuals. Simply responding to the exposure draft has revealed that actuaries within and across NAMIC member companies have different understandings and opinions about the intended meaning of these sections. Some interpret the sections 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 being impacted by changes made to rating characteristics that do not define that group. Others thought that 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>The risk of broad interpretation of the draft language limits the value and practicality of the entire ASOP framework while creating significant potential danger to insurers in the form of litigation and regulatory risks.</p> <p>To the extent Section 3.4 remains, the appropriate standard to be applied is “may” rather than “should”, which is allows for professional judgment contemplated by ASOP No. 1.</p>
Current 3.2.1	Reverse deletion of “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,	The focus on the relationship to expected outcomes is critical to matching price to risk for individual risk subjects. The focus on the use of mathematical and statistical analysis of available data is critical to actuarial ratemaking. These concepts are jeopardized by deletion of the language in the exposed draft.

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	<p>including statistical or other mathematical analysis of available data.”</p> <p>Reverse deletion of “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>Defining equitable rates and fairness in terms of expected cost is inherent to actuarial work products. This concept is jeopardized by deletion of the language.</p>
<p>Current 3.2.2</p>	<p>Reverse deletion of “<u>Causality</u> – While the actuary should select risk characteristics that are related to expected outcomes, it is not necessary for the actuary to establish a cause and effect relationship between the risk characteristic and expected outcome in order to use a specific risk characteristic.”</p>	<p>Deleting the passage regarding “causality” could create uncertainty regarding appropriate applicable standards. Removal of the commitment to correlation suggests that direct causality could be the appropriate standard, notwithstanding the passage in Section 3.2.3 that states “however, the actuary is not required to demonstrate a causal relationship.” The passage should remain for the sake of clarity.</p>
<p>3.2.3</p>	<p>Recommend the first part of the first sentence be removed: “The actuary should have a rational explanation that the relationship between a risk characteristic and a risk measure is not obscure, irrelevant, or arbitrary;”</p> <p>Alternatively, recommend the first sentence be modified to read: “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.”</p> <p>The last sentence: “Whether it is appropriate to use a risk characteristic may depend on societal, regulatory, and industry practices or may depend on the scope and context of the actuary’s work.” should be deleted.</p>	<p>This section needs significant clarification. Actuaries within and across NAMIC member companies have expressed different understandings and opinions about the intended meaning of this section. Some 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. There was also disagreement over what constitutes a “rational explanation.” Some feel it is a low threshold, like the legal interpretation that a rational person could accept the provided explanation as possible. Others feel it means an intuitive or logical explanation. Some feel correlation or predictiveness would count as a rational explanation, since they provide statistical support for a connection between the variable and the outcome.</p> <p>There is also concern that legislators, regulators, and actuaries will all interpret this section differently. Without a firm 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>The first and last sentences in the draft appear to create new standards not based in state law, and that may even conflict with state law. While there are long-standing social considerations that actuaries take into account when establishing rating plans</p>

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		<p>(privacy, controllability, intuitive relevance), in the broader context of the proposed changes the inclusion of the proposed language could undermine cost-based pricing.</p> <p>The ASOP should instead 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. The standard should not be based on personal opinions.</p> <p>The last sentence should be removed because it is not a standard.</p>
3.2.4	Recommend editing the first sentence to remove “assess” and replace with “consider.”	“Should consider” makes the investigation of multivariate effects less prescriptive. The word “assess” means the need to complete an analysis to understand effects; “consider” is more general and more appropriate to the principle.
3.2.5 and 4.1.e.	Recommend editing the first sentence to remove “assess” and replace with “consider.”	“Should consider” makes the investigation of outputs from the risk classification framework less prescriptive. The word “assess” means the need to complete an analysis to understand effects; “consider” is more general and appropriate to the principle. The concept of adverse selection is not something that is easily measured. It is difficult to envision how an actuary would document this effect, other than perhaps documenting their opinion on how close true loss cost was tracked in order to avoid such adverse selection.
3.2.7 and current 2.3	Reverse deletion of “credibility” in Section 2.3 of current ASOP 12, potentially enhanced by a reference to ASOP 25: <i>Credibility Procedures</i> .	This section continues to use the term “credibility” in the analysis of individual risk classes. The lack of a credibility definition will lead to mixed interpretations; the standard dictionary definition of credibility is broader than what is prescribed in several other ASOPs pertaining to credibility.
3.4, 3.7	If an evaluation of “unintended bias” is, in fact made, the documentation of details regarding the evaluation should be clearly set forth.	As drafted, if an evaluation of “unintended bias” was carried out, there is no required disclosure of how the evaluation was conducted, what factors were considered, or the outcome of the evaluation. The only recommendation is for the actuary to consider preparing and retaining documentation, which is meant for consumption only by other actuaries. This seems like an oversight.
3.5	This section should be removed in its entirety.	In addition to lacking any clear tie to expected outcomes or risk measures, this section is redundant with Section 1.2 which states that the actuary should comply with applicable laws.

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3.6	Additional clarity regarding what might fall under “information provided by another party” would be helpful.	It is unclear what might fall under “information provided by another party” that is not either data contemplated by ASOP No. 23 or a model contemplated by ASOP No. 56.
4.1.b.	Better alignment with ASOP 23 and tighter explanation of required model disclosures would make this section both more practical and more informative to report recipients.	<p>The requirement to disclose the “data and models used or relied on” represents a huge increase in data disclosure required. Even ASOP No. 23 which addresses data quality does not require the disclosure of “data” but does require disclosure of source and manner of review. This draft makes it appear that <i>all</i> data must be disclosed, which is impractical, unhelpful, and risks the release of proprietary information depending on the context and audience of the report.</p> <p>Additionally, this section seems to imply that the entire model must be disclosed, which will be impractical and unhelpful for any model that is even slightly complicated, especially those stemming from machine learning. This would also seem to rule out the use of natural language processing or large language models for risk classification. Similar to the previous data disclosure, it risks the release of proprietary information depending on the context and audience of the report.</p>
4.1.e, f, g, h	Either define “effectiveness” and “viability” in Section 2 or by reference to other ASOPs or remove these sections.	“Effectiveness” and “Viability” are used in these sections, but remain undefined. This makes the expectation of disclosures very difficult to interpret.
Appendix / Current Practices	<p>Remove the second sentence: “The use of gender, for example, may not be permitted in some states.”</p> <p>Remove the fifth sentence: “But understanding the precise meanings of “actuarially sound” and “unfairly discriminatory” requires a more nuanced understanding than a simple definition can convey.</p> <p>Remove the sixth sentence: “Additionally, changing views on social structures and advances in data science and analytics have caused actuaries to re-evaluate risk classification frameworks for unfair discrimination which may contribute to socially undesirable inequities in products, services, prices, and availability.”</p> <p>Alternatively, modify the sixth sentence: “Because of changing views on social structures and advances in data science and analytics, actuaries may re-evaluate risk classification frameworks for unfair discrimination.”</p>	<p>An ASOP should provide guidance on concepts such as “actuarially sound” and “unfair discrimination” rather than simply saying they are nuanced.</p> <p>The addition of a “nuanced understanding” related to changing views on social structures suggests an inappropriate shift away from the focus on matching price to risk.</p>

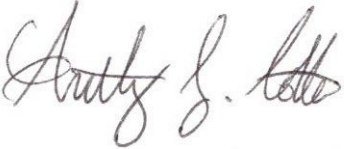
IV. General Recommendations (If Any):

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Commentator Recommendation (Identify relevant sections when possible)	Commentator Rationale (Support for the recommendation)
Please see comment letter submitted accompanying the completed template.	

V. Signature:

Commentator Signature	Date
	May 1, 2024