

Comment #8 – 4/27/16 – 5:25 p.m.

Dear Actuarial Standards Board:

I am writing to comment on the second exposure draft of the proposed Actuarial Standard of Practice (ASOP), Property/Casualty Ratemaking. I am submitting these comments on my own behalf, but they represent the perspective of an actuary who has served as a regulator of property/casualty rates in the state of Washington for nearly 30 years.

When I reviewed the first exposure draft of this ASOP last year, I also had a new draft of the Casualty Actuarial Society (CAS) Statement of Principles on Ratemaking to consider alongside the ASOP. I submitted comments on both documents, and I could see how the draft Statement of Principles and the draft ASOP did or did not fit together. This time there is no revised Statement of Principles from the CAS to consider, which makes it much more difficult to comment on the appropriateness and adequacy of the draft ASOP. How do I know whether both documents combined will meet regulators' needs? For example, now that the concept of "expected value of all future costs" has been removed from the ASOP, how do I know that this concept will be preserved in the CAS Statement of Principles? Though the Actuarial Standards Board (ASB) is independent of the CAS, it must recognize that this ASOP will not be used in a vacuum; it will be used in the context of other relevant documents such as the CAS Statement of Principles. There was some coordination between the ASB and the CAS last year. Have you given up on this?

Another of my concerns about this second exposure draft is an issue that was also present to some extent in the first exposure draft. But the issue is much more striking to me in this second exposure draft. The problem is with the definition of the term rate. When rate is defined as "an estimate of all future costs per exposure unit associated with an individual risk transfer," it is defined to mean something other than what it means in most other contexts, including the insurance industry and the legal environment. This will be a source of endless confusion for actuaries and others who seek to apply this ASOP. In those other contexts, rates are the numbers that are used to calculate the premiums that policyholders are actually charged. But in this ASOP they are not.

This second exposure draft itself demonstrates the confusion in several places. For example:

- In sections 3.2 and 3.4 the ASOP speaks of estimating the rate. When you plug in the definition of rate, you find that this means estimating an estimate, which is nonsense in English.
- In section 3.7.1 the ASOP speaks of adjusting premium data to reflect a consistent rate level. But premium data is not directly related to the rate level, because the rates are only estimates, not what was actually charged. This paragraph also refers to rate changes, in a context where it is meaningless to refer to changes in cost estimates.
- In sections 3.7.3 and 3.14 the ASOP refers to a period in which rates will be "in effect." In what sense are mere estimates of future costs "in effect"?

Thus this draft ASOP seems to have great difficulty living with its own definition of rate. It keeps wanting to use the term rate in another sense.

In addition, Appendix 2, though technically not part of the standard of practice, clearly uses the term rates in a different (i.e., its ordinary) sense. States don't regulate estimates of future costs; they regulate base rates, rating factors, and rating rules that determine what policyholders are actually charged.

Finally, in the third paragraph of section 1.2, I would encourage you to delete the sentence, "While the actuary may play a key role in the company's decisions in determining the price charged after taking into account other considerations, such as marketing goals, competition, and legal restrictions, this standard does not address the other considerations." There are many things actuaries do that are not addressed by this ASOP. There is no need for this ASOP to single out one particular activity and give actuaries explicit approval to "play a key role" in that activity. This sentence causes only confusion, and it has been understood by many readers as the ASB's endorsement of activities such as price optimization. I doubt that that is your intent.

I hope these comments are helpful.

Sincerely,

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