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April 21, 2016

Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

Via email to comments@actuary.org

RE: Second Exposure Draft, Proposed Actuarial Standard of Practice (ASOP), Property/Casualty Ratemaking

Thank you for the opportunity to provide comments on the proposed Actuarial Standard of Practice (ASOP), *Property/Casualty Ratemaking*. The American Academy of Actuaries[1] Casualty Practice Council (CPC) has reviewed the exposure draft and offers the comments below. We begin with responses to the Request for Comments in the Transmittal Memorandum followed by additional comments on specific sections of draft ASOP itself.

Request for Comments

1. *Are there any conflicts between the proposed ASOP and existing practice?*

    The ASOP appears to adhere to a fairly strict construct of a rate being "per exposure unit," i.e., the standard is written in the context of manual ratemaking. This potentially conflicts with current practices wherein rates are developed as flat charges as is common for some types of reinsurance and where there is no exposure unit.

2. *This standard is proposed to be effective for work "performed on or after" four months following the adoption of the standard. Does this language appear to create any undue burden?*

    The standard applies to a range of activities involving ratemaking all of which could be associated with the same end product. For example, one or more actuaries may develop the rates, a different actuary (or actuaries) may review the rates and possibly

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[1] The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policy makers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

another actuary could be engaged in providing professional services as an expert witness in a case about the developed rates. The timeline on these activities could stretch well beyond four months. If it is desirable to maintain a consistent standard across all the potential activities associated with a single rate development project, changing Section 1.4 as follows could effect that change:

> "This standard is effective for rates that were initially developed on or after four months following adoption by the Actuarial Standards Board."

3. *Is it clear that this ASOP does not provide any guidance on the use of what is generally referred to as "price optimization," which relates to the company's decisions in determining price?*

   It is clear that the intent is to limit the application of this standard only to the actuary's role associated with the estimation of future costs as stated in Section 1.2 *Scope*. The current Casualty Actuarial Society *Statement of Principles Regarding Property and Casualty Insurance Ratemaking* provides a very clear statement to that effect stating that "the principles in this Statement are limited to that portion of the ratemaking process involving the estimation of costs associated with the transfer of risk." A similar statement could be made in this ASOP changing Section 1.2, paragraph 3 as follows:

   > "This standard is limited to <u>that portion of the ratemaking process involving</u> the estimation of future costs. ~~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.~~"

4. *The task force eliminated the reference to "expected" value of all future costs to eliminate the possible confusion that the only appropriate estimate of all future costs was a mean value without any consideration of potential variability. Is this change appropriate? Does this change lead to confusion about what is being estimated?*

   In our prior comments we advocated eliminating "expected value" to recognize that not all rates are developed based on the mean value and to eliminate the possible confusion associated with the term. We also introduced the concept of the "intended measure" – or more accurately, we borrowed the concept of the intended measure from ASOP 43. We believe that the concept of an intended measure is applicable to the ratemaking process. It is important to identify and describe what the actuary is measuring. For example, for typical personal lines insurance it may be useful to use a measure of the mean for the risk transfer cost estimate, whereas in some cases the desired rates would not be based on a mean value, but on some other metric (such as a specified percentile.) This could occur in the case of a self-insurance pool or exchange that wants rates based on something higher than the mean costs, with potential for future dividends (and to preclude the need for future assessments). Below, we suggest changes to several sections to add the concept of the intended measure.

5. *Is it clear within the definition of ratemaking, section 2.8, that the ASOP provides guidance regarding the estimation of future costs at more refined levels than the aggregate?*

   It is clear that the ASOP provides guidance on estimating future costs both at the aggregate level and at more refined levels.

6. *Is it clear that this ASOP applies to elements of the rate, such as loss costs developed by advisory organizations such as ISO, NCCI, and AAIS?*

   The first paragraph of Section 1.2, *Scope* does clarify that the ASOP applies to the estimation of elements of the rate such as only the loss cost portion. However, we suggest two changes below to further clarify this application.

Specific Section Comments

Because the draft ASOP applies to the development of rates or a portion of rates, we believe the following change is needed to Section 3.1, *Introduction* as follows:

> "The actuary should identify <u>the intended measure</u> and consider the costs associated with the elements that make up the **rate**. Such elements ~~should~~ <u>may</u> include, but are not limited to, loss and loss adjustment expenses, operational and administrative expenses, and the cost of capital."

For the same reason, we believe the following change is needed to the second paragraph of Section 3.2, *Organization of Data*:

> "There are several acceptable aggregation **methods** including, but not limited to, aggregating by accident period, calendar period, policy period, and report period. The nature of the insurance **coverage**, <u>the element of the rate being estimated</u>, and the type of **ratemaking** analysis will influence the selection of the data aggregation **method**…"

In regards to our response to question #4, above, we suggest the following edit to the beginning of Section 3.4:

> "The actuary should select appropriate **methods** and **models** for estimating the <u>future cost of the components, consistent with the intended measure,</u> <u>that make up the</u> **rate** or portion of the **rate…"**

We suggest adding "<u>and reserving</u>" to the last phrase of 3.7.2, first paragraph:

> "…and the underlying claims adjustment <u>and reserving</u> process."

We suggest adding the word "<u>may</u>" to the second sentence of Section 3.7.3 as not all of the adjustments will be relevant.

> "These adjustments <u>may</u> include, but are not limited to the following:"

Additional Comments

In our prior comments in January 2015 we advocated for this ASOP to address regulatory filings. We continue to believe that an ASOP directly addressing regulatory filings for property and casualty rates would be helpful to the profession. The current ASOP No. 8, *Regulatory Filings for Health Plan Benefits, Accident and Health Insurance, and Entities Providing Health Benefits,* provides an excellent template for preparing an ASOP for property / casualty regulatory filings.

The CPC appreciates this opportunity to provide comments to the CAS. We hope these observations are helpful, and we welcome further discussion. If you have any questions about our comments, please contact Marc Rosenberg, the Academy's casualty senior policy analyst, at rosenberg@actuary.org or (202) 785-7865.

Sincerely,

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American Academy of Actuaries