

Title of Exposure Draft: Risk Classification (for All Practice Areas)

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
American Academy of Actuaries' Health Practice Council

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	Delete or clarify second sentence – "This standard also applies to actuaries when performing actuarial services with respect to using any elements of a risk classification framework in connection with financial or personal security systems, to the extent practical and consistent with the scope of the actuary's assignment."	The second sentence broadens the scope to actuarial work indirectly affected by the risk classification, such as rerating of guaranteed renewable policies where premium rates are to be by class. Would this sentence also include using a rate manual or calculating risk scores using a specified model, such as the CMS risk models? We request clarification on how this standard applies to work using health-status-based risk adjustment. The scope of ASOP No. 45 currently indicates that usage of risk adjustment models is covered by ASOP No. 45, but designing, reviewing, or changing risk adjustment models is covered by ASOP No. 12. Does the proposed second sentence mean that usage of a risk adjustment model is governed by both ASOP No. 12 and ASOP No. 45?
1.2	Section 1.2 notes that practice-area ASOPs supersedes this ASOP, should there be a conflict. However, we note that practice-area ASOPs	If the practice-area ASOPs supersede this ASOP, then the actuary may not consider unintended bias as is intended by this ASOP.

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	sometimes include guidance on setting assumptions that do not include consideration of unintended bias.	
2.2	Change “Financial or Personal Security System” to “Financial Security System.” Add examples of “direct service” systems, such as prepaid medical, CCRCs.	We believe that “Financial Security System” better captures the meaning. If the inclusion of “Personal Security” is meant to cover the “direct services,” we feel that the term “financial security” is sufficient because direct service products mitigate financial risks. We support including more examples of direct service plans, similar to the current definition.
2.3 and 2.4	Define “Risk Characteristics” more fully. Such as, Risk Characteristics – Attributes of a risk subject that are predictive or associated with a risk measure.	The definitions of “risk characteristics” and “risk class” refer to each other. The basic element is the risk characteristic. Can that be better defined?
2.5	Change “schema” to “categorization.” Add “such that each risk subject must be assigned to one and only one risk class”.	We believe categorization is a better description and the concept of exclusivity is important, which is in the current ASOP definition of Risk Characteristics.
2.6	Add the words “intended to be” before mitigated. Add “morbidity rates” to the list of examples.	In some coverages, multiple risk measures may be used and may offset each other. For example, in LTC, the morbidity risk may be partially offset by longevity risk.
2.8	We recommend changing the term to “Unintended Discrimination” and modifying the definition to describe the potential for discrimination that results from bias.	The current definition of “unintended bias” is unclear. Bias is an input that can result in discrimination; therefore, it may be clearer to define the term “unintended discrimination.” We recommend that the definition clearly state that the impacts or outcomes are discriminatory and result from underlying bias in the data used, methodology, or application of the risk classification framework. We also note that the term “discrimination” should be defined, since it has particular legal meaning.
2.8	Revise “specific risk subjects” to “specific risk subjects or groups of risk subjects.”	The definition of unintended bias refers to “specific risk subjects,” but we believe it would be more correct to reference “groups of risk subjects.”
3.2.1	Replace “confirm that” with “consider whether.”	“Confirm that” seems like a strong term given that the scope includes “developing” and “opining.”
3.2.2	Concern with reference to “model” and ASOP No. 56.	We question whether a risk classification framework is always a model. For example, risk classification is used for rate manuals. We do not believe that a rate manual is a model.
3.2.3	We recommend retaining the wording from the first paragraph of the current section 3.2.1 with a clarification and 3.2.2 instead of the revised wording in the first paragraph of the proposed section 3.2.3. We recommend striking: “The actuary should have a rational explanation that the relationship between a risk characteristic and a risk measure is not obscure, irrelevant, or arbitrary; however, the actuary is not required to demonstrate a causal relationship.” Our recommendation to replace the 1 st paragraph of 3.2.3:	The use of the term “rational explanation” appears to undermine the need for rigor when considering the relationship between risk characteristics and risk measures. We recommend rephrasing this entire section to provide guidance related to what the actuary should do or should consider.

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	<p><u>“The actuary should select risk characteristics that are related to expected outcomes. However, the actuary is not obligated to use all risk characteristics related to the 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, including statistical or other mathematical analysis of available data. The actuary may also use clinical experience and expert opinion. 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.”</u></p>	
3.2.5	<p>Section 3.2.5 “We recommend deleting this sentence or modifying it as follows: “The actuary should take into account that a lack of consider ongoing monitoring of the risk classification framework may increase mitigate the risk of adverse selection.”</p>	<p>Once again, this sentence does not provide guidance as to what the actuary should do.</p>
3.2.6	<p>Section 3.2.6, recommend expanding this to discuss how to consider incompleteness/nonresponse bias.</p>	<p>Sometimes, even when we have objective data, the incompleteness or lack of interrogation of that data might lead to bias. Furthermore, something like geography might be pretty objective, but that shouldn’t excuse its use without consideration of its relationship to risk characteristics that are less objective.</p>
3.2.7	<p>Add language on using the minimum necessary number of risk classes.</p>	<p>The first sentence notes that cost, time, and effort associated increases as the complexity increases. The current ASOP more plainly states that the cost, time, and effort increases with the number of risk classes.</p>
3.2.8 and 3.2.9	<p>Recommend defining “effectiveness” in a broad manner to take into account more than just the financial viability.</p>	<p>With respect to the use of the term “effectiveness,” effective from whose perspective? Defining effectiveness narrowly to reflect only the financial viability of the system would ignore the potential harm done to people who could be left out of this system as a result.</p>
3.4	<p>Recommend removing “as appropriate” from Section 3.4.</p>	<p>Section 3.4 notes that actuaries should consider the potential for unintended bias, but the qualifier that follows, “as appropriate,” gives an out. That sentence also reads awkwardly.</p>
3.5	<p>Recommend removing “if applicable”.</p> <p>Recommend explicitly noting that a risk classification system has the potential to result in unintended bias against protected classes even if those protected classes aren’t included as a risk characteristic.</p>	<p>The multiple uses of “if applicable” seems redundant in this section.</p> <p>We believe it is important to state that a risk classification system has the potential to result in unintended bias against protected classes, even if those protected classes aren’t included as a risk characteristic.</p>

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4.1	Update Section 4.1 to include disclosures from Section 3.4 and Section 3.5.	Section 4.1 suggests actuaries disclose certain considerations from section 3, but seems to exclude the suggestion to disclose section 3.4 (potential for unintended bias) and 3.5 (protected classes).
4.1.j.	Add “establish a recommended monitoring frequency to test effectiveness (g), and the impact of adverse selection (e).”	Section 3.2.5. says that the actuary should take into account that the lack of ongoing monitoring may increase the risk of adverse selection. We suggest adding monitoring as a disclosure in section 4.1.
Appendix Background Section	Update the background section to include more recent articles.	In the appendix’s background section, the list of literature that provides background on risk classification only goes to 2011 and doesn’t include more recent publications. We recommend at least including these papers: https://www.casact.org/publications-research/research/research-paper-series-race-and-insurance-pricing .
Appendix Current Practices Section	Recommend reviewing and revising the wording of the last 4 paragraphs for clarity.	Recommend reviewing the wording of the last four paragraphs, specifically the last paragraph referring to section 4.1(h) as requiring disclosures related to significant adverse selection. Adverse selection is addressed in section 3.2.5 but section 4.1(h) refers to section 3.3.
Appendix Current Practices Section	We are concerned with this sentence: “Risk classification issues in some instances may pose a dilemma for an actuary working in the public policy arena when political considerations support a system that contradicts to some degree practices called for in this ASOP.” We suggest adding language on the actuarial profession’s responsibility to inform policymakers about the implications of the approaches and potential mechanisms that can mitigate the effects of prohibiting particular risk classifications systems or factors.	As noted in 3.2.3, the appropriateness of using particular risk characteristics may depend on societal, et al. practices. The policy world has to balance oftentimes competing priorities. The actuarial profession has a responsibility to inform policymakers about the implications of approaches they are considering. Ultimately, policy decisions may be made that skew toward priorities other than those prioritized by the profession. In some instances, the policies implemented incorporate additional mechanisms that can mitigate the effects of prohibiting particular risk classification systems or factors. So, in other words, even if the practices called for in the ASOP are contradicted, the overall goal of viability could still be met.

IV. General Recommendations (If Any):

Commentator Recommendation (Identify relevant sections when possible)	Commentator Rationale (Support for the recommendation)
We suggest that the transmittal be updated to include the rationale for removing definitions (such as advice, credibility, homogeneity, and practical), clarifying whether they were removed because they are commonly accepted or for some other reason, the rationale for changing definitions, and the rationale for sections added to the ASOP.	The requested information will provide more clarity to the profession.
Throughout the standard, guidance seems to indicate what the actuary should not do, etc. The focus should be on actionable items for the actuary.	This would make it more straightforward for actuaries to follow the ASOP.

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The Appendix's Current Practice Section is the only place where equity is mentioned. Can equity be added as a definition in section 2 or added to the content of the ASOP?	Mentioning equity only in the Appendix makes it seem like equity is an afterthought.
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V. Signature:

Commentator Signature	Date
/s/ Barbara Klever, Vice President, Health Practice Council, American Academy of Actuaries	May 1, 2024