



May 1, 2024

Actuarial Standards Board
 1850 M Street NW, Suite 300
 Washington, DC 20036
 Via email to comments@actuary.org

Re: ASB Comments—Comments on Exposure Draft of Proposed Revision of ASOP No. 12

Members of the Actuarial Standards Board:

The Pension Committee of the American Academy of Actuaries¹ is pleased to present the following comments to the Actuarial Standards Board (ASB) regarding the exposure draft of the proposed revision of Actuarial Standard of Practice No. 12, *Risk Classification (for all Practice Areas)* (ASOP No. 12) We believe much good work has been done to update this ASOP.

We have the following comments on the current exposure draft in the format you requested. Note that recommended new text has been underlined.

I. Identification:

Name of Commentator / Company
Pension Committee, American Academy of Actuaries

II. ASB Questions (If Any). Responses to any transmittal memorandum questions should be entered below.

Question No.	Commentator Response
	There are no specific questions posed in the exposure draft.

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, except for second paragraph	“This standard applies to actuaries <u>in any practice area</u> when performing actuarial services with respect to designing, developing, selecting, modifying, <u>using</u> , reviewing, <u>or</u> evaluating, or	Actuaries in all practice areas are currently subject to more recent actuarial standards of practice (ASOPs) such as ASOP No. 56, <i>Modeling</i> (ASOP No. 56). To make it easier for actuaries to review and

¹ The American Academy of Actuaries is a 20,000-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 policymakers 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

	<p>opining on any elements of a risk classification framework in connection with financial or personal security systems. 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.</p> <p><u>If the actuary's actuarial services involve reviewing or evaluating any elements of a risk classification framework in connection with financial or personal security systems, the reviewing or evaluating actuary should be reasonably satisfied that the actuarial services were performed in accordance with this standard. The reviewing or evaluating actuary should apply the guidance in this standard to the extent practicable within the scope of the actuary's assignment.</u></p> <p><u>Other ASOPs may provide guidance for actuarial services that involve risk classification frameworks. If the actuary determines that the guidance from another ASOP in this standard conflicts with the guidance of this ASOP, the guidance of the other a practice area ASOP, the practice area ASOP will governs.</u></p> <p><u>If the actuary departs from the guidance set forth in this ASOP in order to comply with a conflict exists between this standard and applicable law (statutes, regulations, and other legally binding authority), or for any other reason, the actuary should refer to section 4. If a conflict exists between this standard and applicable law, the actuary should comply with applicable law. If the actuary departs from the guidance set forth in this standard in order to comply with applicable law, or for any other reason the actuary deems appropriate, the actuary should refer to section 4."</u></p>	<p>comply with general ASOPs applicable to all practice areas, it would be helpful if the general wording at the beginning of the ASOPs is consistent. There are a few small differences in this standard compared to ASOP No. 56. If the deviations in parallel language are deliberate, that intention should be clarified in order to eliminate the confusion these small differences may cause. To aid in understanding, we propose a few minor changes to this section.</p> <ul style="list-style-type: none"> - It is important to clarify in the scope statement that the standard applies to all practice areas. - We also think that consistent wording in ASOP No. 56 would result in more streamlined and clearer language. - We suggest incorporating language from ASOP No. 56 that refers to the applicability of the standard when the actuary's responsibilities only apply to "reviewing" and "evaluating" and not any of the other actions. - The concept of "opining" isn't currently in the standard and there does not seem to be a rationale to introduce it. Additional clarification is needed as it relates to "opining" on a risk classification framework that is not applicable to models under ASOP No. 56, given that opining is not otherwise referenced within ASOP No. 56, nor is it covered under the actions listed in section 1.2's first paragraph. When one evaluates a framework, they generally develop an opinion as to whether the framework is appropriate for the actuarial services being performed. - The differing language around conflicts across ASOPs, as well as with applicable law, may be confusing. We would suggest using consistent language with ASOP No. 56, unless a different result is expected.
1.2, second paragraph	<p>"The guidance in this ASOP does not apply to actuaries when performing actuarial services with respect to individual pension benefit calculations or nondiscrimination testing, as described in section 1.2 of ASOP No. 4, <i>Measuring Pension Obligations and Determining Pension Plan Costs or Contributions</i>."</p>	<p>We suggest that the language in this second paragraph be revised to be parallel with ASOP No. 56 to make the specific reference clear. Performing individual pension benefit calculations are presumably not actuarial services, as they are not required to be performed by an actuary. Rather, they reflect the detailed administration requirements outlined in a legal plan document, without requiring professional judgment.</p> <p>Consistent with other ASOPs, it is important to provide not just the ASOP number, but also the relevant section number to make it easier for the actuary to locate the cross-reference. This is</p>

		another potentially confusing difference from the wording in ASOP No. 56.
1.3	“When this standard refers to the provisions of other documents, the reference includes the referenced documents as they may be amended or restated in the future, and any successor to them, by whatever name called. If any amended or restated document differs materially from the originally referenced document, the actuary should <u>consider</u> follow the guidance in this standard to the extent it is applicable and appropriate.”	We suggest that the language in this section be revised to be parallel with ASOP No. 56. We noted that the word “consider” was used in the current ASOP No. 12, as well as in ASOP No. 56. If the word “follow” had been intentionally substituted and requires something different than what is currently followed in ASOP Nos. 12 and 56, a clarification as to why would be welcome.
Section 2, additional definitions	<p>“<u>Intended Purpose – the goal or question, whether generalized or specific, addressed by the risk classification framework within the context of the assignment.</u>”</p> <p>“<u>Intended Use - a more specific utilization of the risk classification framework results identified by the actuary that is consistent with the broader intended purpose.</u>”</p>	We noted that some definitions had been removed and some added. “Intended purpose” is not defined in ASOP No. 1 but is defined in ASOP No. 56. We would strongly encourage replicating the ASOP No. 56 definition of intended purpose here (with the word “model” replaced by “risk classification framework”). It appears that a consideration of the intended purpose was added to the standard in section 3.2.1, which includes confirming the intended use. We recognize there are differences between the two; defining “intended use” in this context would be helpful. In the current ASOP No. 12, the discussion regarding intended use appears in section 3.3.1; however, it is not included in this exposure draft.
2.2	“A private or governmental program that is intended to mitigate the impact of unfavorable outcomes of contingent events. Financial or personal security systems include systems where the mitigation takes the form of financial payments, direct service to the risk subject , or both. Examples include insurance, self-funded programs , Medicare, and pension plans.”	It is unclear what is meant by a self-funded program, because some insurance can be self-funded or fully insured (e.g., a company-provided medical insurance benefit). We recommend either removing the example or providing additional specificity on what is intended by the phrase “self-funded programs” that are not insurance in the context of this standard.
2.3 / 2.4	<p>“Risk characteristics – Attributes used to assign each risk to one of the risk classes derived from a risk classification process used to assign risk subjects to the risk pool or risk class for common treatment.</p> <p>Risk class – A set of risks subjects based on risk characteristics. A group or a pool of risk subjects aggregated in accordance with risk characteristics.”</p>	These two definitions appear circular. We have suggested alternative language to clarify that risk characteristics are outcomes of the risk classification process, which are then applied to group risk subjects into appropriate risk pool(s).
2.6, title of section	“ <u>Pooled Risk Measure</u> ”	Generally, the term “risk measure” is used as some kind of measurement of deviation from expected outcome, such as standard deviation. In this standard, it seems to be applied to expected values of outcomes of contingent events across risk pool. Therefore, we suggest adding the word “pooled” to the defined term “risk measure.”

3.2.1	“The actuary should confirm, <u>in the actuary’s professional judgment</u> , that the risk classification framework is appropriate for the intended purpose and intended use. ”	We suggest that the language in this section be revised to parallel ASOP No. 56, which refers solely to “intended purpose” and not “intended use.” “Intended purpose” is a clearly defined term in ASOP No. 56, but it is unclear what is to be considered in “intended use,” which is not a defined term. If the proposed definition of “intended use” is added, it may be appropriate to retain that wording in this section; however, the reason for the deviation from the wording in ASOP No. 56 would need to be explained.
3.2.2	“The actuary should confirm that the data and model(s) used for the risk classification framework are appropriate <u>for the intended purpose.</u> ”	We suggest that the language in this section be revised to be consistent with ASOP No. 56. Adding “for the intended purpose” after “appropriate” provides context for determining for what it would be appropriate.
3.2.4	“ <u>To the extent practical, the actuary should take into account and generally identify potential</u> assess whether multivariate effects, interdependencies, or correlations among risk characteristics that may be are material to the assignment of risk subjects to an appropriate risk class . To the extent practical, the actuary should take into account multivariate effects, interdependencies, or correlations. ”	This appears to require a considerable amount of analysis to prove that the multivariate effects, interdependencies, or correlations are not material. Allowing for more qualitative assessments may be appropriate. We also propose striking the second sentence, as it is not necessary in our more streamlined wording as it is covered in the previous sentence. By modifying these sentences, we believe the practical application of the concept is clarified and allows for a more qualitative assessment.
3.2.5	“The actuary should <u>generally identify</u> assess the potential for adverse selection effects that may result or have resulted from the design, development, selection, modification, or continued use of the risk classification framework .”	This appears to require a considerable amount of analysis of potential areas of adverse selection. It is more appropriate to allow for more qualitative assessments.
3.2.7.	“ <u>c. the balance between the cost and effort for additional refinement of risk classes and the additional accuracy derived from that effort.</u> ”	It is important to consider whether the cost and effort of additional refinement is justified, in the actuary’s professional judgment. Although “cost” is mentioned in the first sentence of section 3.2.7, there isn’t anything in this section that discusses clearly how to take the cost into consideration.
3.2.9	Provide more clarity in wording	This appears to require a considerable amount of analysis to evaluate effectiveness. It also isn’t clear what is intended by “effectiveness” and “viability.” If this concept is retained in the standard, further clarification should be provided to indicate what is intended. We would also propose including language that allows for a more qualitative consideration.
3.2	“Considerations for a <u>Risk Classification Framework</u> – The intended purpose of and approaches to a risk classification framework can vary significantly. The actuary should	The term “risk classification” is not defined within the standard, so we have proposed replacing it with the defined term, “risk classification framework.” We also propose adding “models” to

	exercise professional judgment when providing actuarial services related to a risk classification framework . The actuary may use data, information, <u>models</u> , or studies that are reasonable in the actuary’s professional judgment.”	what an actuary may use in the last sentence. In some cases, pre-existing risk classification models, such as health care risk scoring models, may be utilized by the actuary when providing actuarial services related to a risk classification framework.
3.3	<p>“When modifying, using, reviewing, or opining on any element of an existing risk classification framework, the actuary should understand the frequency of past reviews and the extent of previous changes made to <u>evaluate emerging experience and assess whether or not the risk classification framework remains appropriate for its intended purpose.</u></p> <p>The actuary should consider take into account whether past, recent, or expected potential changes or lack of changes made to the risk classification framework have the potential to have a material adverse impact on the effectiveness of the risk classification framework or on the viability of the financial or personal security system.</p> <p>To the extent readily available, the actuary should take into account whether the risk classification framework will remain appropriate for its intended purpose and use. Such changes could include those affecting the risk characteristics or risk measures used for risk classification <u>should consider the rationale behind the risk classification framework, past reviews of the risk classification framework, and the extent of previous changes made to the risk classification framework.”</u></p>	In the current standard, section 3.4 covers testing of the risk classification system, which is closely related to, but not the same as, this new section. As drafted, section 3.3 deals with a risk classification framework that potentially exists prior to the actuary’s assignment. We have proposed language to better describe the potential actions of the actuary, starting with an evaluation of the current appropriateness of the existing framework, followed by reviewing or evaluating any previous or future potential changes, if warranted. Finally, it may be helpful to understand the rationale behind the existing risk classification framework or prior reviews/changes, if available. To avoid considerable amounts of required analysis, we also propose including language that reflects a more qualitative assessment.
3.7, last sentence	“The degree amount, form, and detail of such documentation should be based on the professional judgment of the actuary and may vary with the complexity and purpose of the actuarial services. In addition, the actuary should refer to ASOP No. 41, <i>Actuarial Communications</i> , <u>Section 3.8</u> , for guidance related to the retention of file material other than that which is to be disclosed under section 4.”	We suggest that the language in this section be revised to match ASOP No. 56.
4.1	<p>“When issuing an actuarial report <u>under this standard</u>, the actuary should refer to ASOP Nos. 23, 41, and 56. In addition, the actuary should disclose the following in such actuarial reports, if applicable:</p> <p>a. the intended purpose and intended use of the risk classification framework (see section 3.2.1); </p>	<p>We suggest that the language in this section be revised to be consistent with ASOP No. 56. In particular:</p> <ul style="list-style-type: none"> - For 4.1(a), as previously noted, ASOP No. 56 does not include the “intended use” and it is not clear what additional analysis is required. - For 4.1(e), the requirement in 3.2.5 is around the “potential” for adverse selection.

	<p>e. the <u>potential</u> impact of significant adverse selection on the effectiveness of the risk classification framework or on the viability of the financial or personal security system (see section 3.2.5)</p> <p>.....</p> <p>g. <u>a summary of key points evaluated for the effectiveness of the risk classification framework on the viability of the financial or personal security system</u> (see section 3.2.9);</p> <p>.....</p> <p>i. <u>extent of reliance on information provided by another party</u> (see section 3.6).”</p>	<ul style="list-style-type: none"> - For 4.1(g), indicate what should be disclosed for “effectiveness.” - For 4.1(i), consistent with ASOP No. 56, the extent of the reliance should be documented. <p>Although not modified on the left, we note that ASOP No. 56 uses “as discussed in section X.X,” while this standard uses “(see section X.X).”</p>
4.2	<p><u>“Additional Disclosures in an Actuarial Report—The actuary should include the following, as applicable, in an actuarial report:</u></p> <ul style="list-style-type: none"> a. <u>the disclosure in ASOP No. 41, section 4.2, if any material assumption or method was prescribed by applicable law;</u> b. <u>the disclosure in ASOP No. 41, section 4.3, if the actuary states reliance on other sources and thereby disclaims responsibility for any material assumption or method selected by a party other than the actuary; and</u> c. <u>the disclosure in ASOP No.41, section 4.4, if, in the actuary’s professional judgment, the actuary has otherwise deviated materially from the guidance of this ASOP.</u> <p>Additional Disclosures in an Actuarial Report—The actuary also should include disclosures in an actuarial report in accordance with ASOP No. 41 for the following circumstances:</p> <ul style="list-style-type: none"> a. if any material assumption or method was prescribed by applicable law; b. the disclosure in ASOP No. 41, if the actuary states reliance on other sources and thereby disclaims responsibility for any material assumption or method selected by a party other than the actuary; and e. the disclosure in ASOP No. 41 if, in the actuary’s professional judgment, the actuary has otherwise deviated materially from the guidance of this standard.” 	<p>We suggest that the language in this section be revised to match ASOP No. 56.</p>
Appendices	Delete appendices	<p>Consistent with our comments on other exposure drafts, we propose eliminating the appendices. We do not believe they offer additional context to help actuaries apply the standard to their practice. Information in appendices is not considered guidance or part of the standard, so they should not be included in a standard. Instead, the various practice councils and committees should consider preparing practice notes that describe how actuaries may want to comply with these standards, including background and other</p>

		information described in the appendices. The list of references, while very good today, will quickly be outdated. These references would be better maintained on an Academy website for easy access to the most current information.
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IV. General Recommendations (If Any):

Commentator Recommendation (Identify relevant sections when possible)	Commentator Rationale (Support for the recommendation)
See above for suggested changes consistent with these general recommendations.	We had two general comments that occurred in most of our comments above: <ol style="list-style-type: none"> 1. In general, there were concepts and associated wording approved for all practice areas within ASOP No. 56. To avoid confusion and conflicting standards, consistency among similar concepts and how they are applied seems both reasonable and appropriate. 2. In general, there were several places where it was unclear whether an assessment needs to be a complicated quantitative analysis or if a more general qualitative consideration could be used to satisfy the standard. We suggest the more qualitative approaches be allowed and that the wording be clarified to allow for that option.

V. Signature:

Commentator Signature	Date
See below	May 1, 2024

We appreciate the ASB’s consideration to these comments. Please contact Philip Maguire, the Academy’s retirement policy analyst (maguire@actuary.org), if you have any questions or would like to arrange a convenient time to discuss this matter further.

Respectfully submitted,

Grace Lattyak, MAAA, FSA, EA
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 American Academy of Actuaries