

Professionalism and the Practicing Actuary

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The Importance of Professionalism: Increased Scrutiny of Actuaries

- ▶ Standard and Poor's analysis (2003)
 - "Insurance Actuaries: A Crisis of Credibility"
 - Blamed actuaries for reserve shortfalls in early 2000s
 - #1 Casualty Actuarial story for 2003 (CAS)
- ▶ Morris Review in the UK (2004-05)
 - Led to oversight by Financial Reporting Council
- ▶ Mealey's Litigation Report (Dailey & Selznick, 2004)
 - "Actuarial malpractice claims proliferated in the 1990s, which saw three times as many cases as the prior two decades combined. If anything, the pace has quickened: more cases have been brought since 2000 than in all the 1990s."

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Purpose of the CAS recognizes Professionalism

- ▶ To advance the body of knowledge in actuarial science applications other than life insurance,
- ▶ To establish and maintain standards of qualification for membership,
- ▶ **To promote and maintain high standards of conduct and competence for its members,**
- ▶ To increase awareness of actuarial science.

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Actuaries are “Professionals”

- ▶ Elements of professional organizations*
 - Knowledge requirements
 - Value system (e.g. ethics)
 - Organizational structure
- ▶ Actuaries possess all three elements

*Source: Bellis et al, *Understanding Actuarial Management: the actuarial control cycle*, Institute of Actuaries of Australia, 2006.

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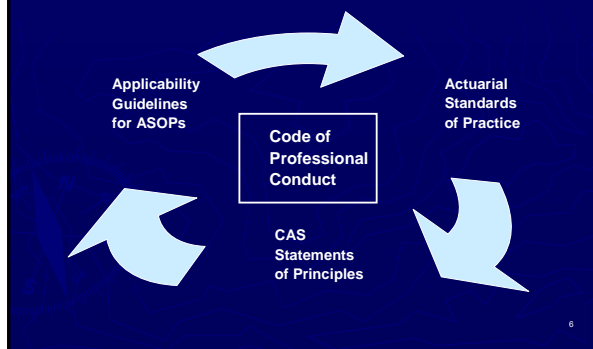
Importance of Written Standards*

1. Checklist of agreed practices
2. Protects Principal and others who may rely on work
3. Protects the Actuary from undue pressure by Principal
4. Provides some protection to Actuary from allegations of misconduct
5. Satisfies regulators that actuaries will perform task to given standards.

*Source: Bellis et al, *Understanding Actuarial Management: the actuarial control cycle*, Institute of Actuaries of Australia, 2006.

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P&C Actuarial Standards and Guidance



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Case Studies



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Case Studies Overview

- ▶ “Real life” predicaments
- ▶ Structure of session
 - Read the case together.
 - Review polling question and raise hand
 - Discussion
- ▶ Disclaimers:
 - Exercise is for education purposes only.
 - Opinions expressed do not represent the opinion of the respective employers or the Casualty Actuarial Society.
 - No authoritative guidance should be expected of the moderator or panelists.

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Question

When was the last time you referred to the Code of Professional Conduct?

- (a) In the past year, to answer a work-related question
- (b) In the past year, to meet continuing education requirements
- (c) Between 1 and 2 years ago, for any reason
- (d) Not since I attended the Course on Professionalism
- (e) More than two years ago, or don't remember.

Case Study #1 – “Coastal Rates”

As the chief actuary for your state's insurance department, you are reviewing a filing by a major personal lines insurer in the state. Due to a rash of recent catastrophes, the company is asking for a 200% increase along the coastline. After reviewing the data, you agree that the rate increase is justified.

The Insurance Commissioner tells you to disapprove the increase because it would result in rates that are not affordable. Your projections show that without the full 200% rate increase, the insurer may go bankrupt within two years. You have shared this information with the Commissioner, but she still refuses to agree to the large rate increase.

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Case #1 Discussion

- ▶ Option (a) – Argue with commissioner
 - Duty owed to public (Precept 1)
 - Document per ASOP 41 and communicate to your Principal/Commissioner (Precept 4)
- ▶ Option (b) – Agree to disapprove filing
 - Commissioner is your Principal
 - ASOPs are your friend – use them to support your position (Precept 3)

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Professional Integrity

- ▶ PRECEPT 1:
An Actuary shall act honestly, with integrity and competence, and in a manner to fulfill the profession's responsibility to the public and to uphold the reputation of the actuarial profession.



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Case Study #2 – “Ranges”

You are the chief actuary for your company and develop a reserve estimate for December 31, 2008 using reasonable methods and assumptions. The opining actuary produces a range using reasonable assumptions and your estimate is materially above the opining actuary's range. Traditionally your company has booked your best estimate but now insists that you lower your estimate to within the range, which is outside your reasonable range. (Assume you have already discussed the difference with the opining actuary)

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Case #2 Discussion

- ▶ Option (a) – Stick to your original recommendation and document results
 - Communications and Disclosure (Precept 4)
 - Document per ASOP 41
- ▶ Option (b) – Lower your range to meet opining actuary
 - Integrity (Precept 1)
 - Booking of the opining actuaries number was action taken by your principal and is out of the scope of ASOP 43
- ▶ Option (c) – Call the ABCD
 - Violation of the Code/Standards (Precept 13)
 - With respect to the opinion actuary they need to follow ASOP 36

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Communications and Disclosure



- ▶ PRECEPT 4:
An Actuary who issues an Actuarial Communication shall take appropriate steps to ensure that the Actuarial Communication is clear and appropriate to the circumstances and its intended audience and satisfies applicable standards of practice.

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ASOP#41: Actuarial Communications

- ▶ All types of Actuarial work – not just P&C
- ▶ Written, Electronic, or Oral Communications
- ▶ Provides guidance for the appropriate form and content that should be included - depending on circumstances and audience
- ▶ Discusses timelines and reliance on others

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ASOP #9: Documentation and Disclosure in P&C Ratemaking, Reserving & Valuations

- ▶ Repeal currently pending
- ▶ Replaced by ASOP #41
 - "Actuarial Communications"
- ▶ Scope – limited to practices related to the 3 Statement of Principles documents
- ▶ Included as appendices

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Case Study#3 – "New Product"

- ▶ You have been the VP of underwriting for the large accounts market for the last three years. The actuary supporting your market along with the marketing department have developed a new product with forms, rates and a 5-year proforma of the expected results of this new product on the market's financial statements. You have reviewed the work and you believe there are some flaws in the pricing and financial modeling. Instead of generating a profit in year 1, the new product will not generate a profit until year 5, if at all. What do you do?

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Case #3 Discussion

- ▶ Option (a) – Talk with the actuary about your concerns
 - Standards of practice (Precept 3)
 - Ratemaking ASOPs (#12, #13, #29, #30, #39)
- ▶ Option (b) – Halt the implementation of the program until problems fixed
 - You are the principal and responsible for ensuring the appropriateness of and expectations about the program's performance (Precept 1)
 - ASOPs are your friend – use them to support your position (Precept 3)
- ▶ Option (c) – Do nothing
 - You are not qualified to make an actuarial statement of opinion (Precept 2)

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Standards of Practice

- ▶ PRECEPT 3:
An Actuary shall ensure that Actuarial Services performed by or under the direction of the Actuary satisfy applicable standards of practice.



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Ratemaking ASOPs

- ▶ #12 Risk Classification
- ▶ #13 Trending in P/C Ratemaking
- ▶ #29 Expense Provisions
- ▶ #30 Profit & Contingency Provision
- ▶ #39 Treatment of Catastrophe Losses in P/C Ratemaking

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Case Study #4 – “Triangle Error”

Your systems vice president recently informed you that there was an error in the loss triangles provided for your loss reserve analysis as of March 31. You run a quick test with the new data and believe it will produce reserve estimates materially higher than your previous best estimate. However, because of recently passed tort reform, you expect your loss experience will improve throughout the year and that the difference will become immaterial by year end. Your CEO shares your expectations about the improved experience and insists you postpone incorporating the new data until the next quarter as your company has already booked your original estimate and rebooking the new reserves would cause a delay in the company's earnings release.

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Case #4 Discussion

- ▶ Option (a) – Update analysis
 - Precept 8 – Misuse of work product
 - Precept 1 – Honesty and integrity
- ▶ Option (b) – Go along with CEO
 - Could support wider range with ASOP 43 (3.6.7 changing conditions)
 - ASOP 23 – Data quality due to tort changes
- ▶ Option (c) - Report CEO to regulators
 - Confidentiality issues (Precept 9)
- ▶ Option (d) – Seek guidance from ABCD

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Control of Work Product

▶ PRECEPT 8:



An Actuary who performs Actuarial Services shall take reasonable steps to ensure that such services are not used to mislead other parties.

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ASOP#23: Data Quality

- ▶ Guidance for the following
 - Selecting data that underlie the work product
 - Relying on data supplied by others
 - Reviewing data
 - Using data
 - Making appropriate disclosures regarding data quality
- ▶ All practice areas – not just P&C
- ▶ Does not require data audit

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Case Study#5 – “Draft Report”

A consulting actuary has delivered a draft report to its client/principal. During a subsequent discussion of the results, the actuary and the Controller talk about the potential surplus impact of a possible strategic course of action. After this conversation the consulting actuary does a thorough proforma analysis and provides a final report in which the results vary from the draft report discussions due to some changes in assumptions as provided by the CEO and CFO. The Controller has already implemented some of the originally discussed strategy and is now complaining to the CEO and CFO that the actuary misled him and has produced faulty work. What should the actuary do?

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Case #5 Discussion

- ▶ Option (a) – Meet with CEO and CFO
 - Communications (Precept 5) and Misuse of work (Precept 8)
 - Your principals are the CEO and CFO and they specified the assumptions that went into your work which should be documented in the final product (Precept 4 and ASOP 41)
- ▶ Option (b) – Meet with the Controller
 - Communication (Precept 4)
- ▶ Option (c) – Do nothing
 - This is an internal battle to your client; STAY OUT OF IT

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Communications and Disclosure

▶ PRECEPT 5:

An Actuary who issues an Actuarial Communication shall, as appropriate, identify the Principal(s) for whom the Actuarial Communication is issued and describe the capacity in which the Actuary serves.

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Case Study #6 – “Insolvent Target”

You are a partner of a consulting firm that has been hired to assist in the review of a potential acquisition. After completing your analysis, you discover that the target is materially under-reserved. The target received an unqualified Statement of Actuarial Opinion from another consulting actuary. As a result of your work, the acquiring company walks away from the target. (You signed a confidentiality agreement with the acquiring company prior to being engaged on the assignment.)

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Case #6 Discussion

- ▶ Option (a) – Your responsibility ended with the principles ending of the project/acquisition
 - Confidentiality – (Precept 9)
 - Your communications with your principal were clear and the principal's decision was consistent with your findings.
- ▶ Option (b) – Report your findings to regulators
 - Integrity (Precept 1)
- ▶ Option (c) – Seek counseling from the ABCD
 - Precepts 1 and 9 may be in conflict with each other

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Confidentiality

► PRECEPT 9:

An Actuary shall not disclose to another party any Confidential Information unless authorized to do so by the Principal or required to do so by Law.



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Case Study #7 – “Auditor’s Actuary”

A consulting actuary is hired to review a company’s loss reserves and subsequently issues an unqualified Statement of Actuarial Opinion. The actuary for the company’s audit firm estimates a deficiency in the reserves when she performs her review, and as a result the auditor will not sign off on the company’s financial statement.

Discussions between the two actuaries become heated. Eventually, the actuary for the audit firm issues a statement to the company, as well as to the regulators criticizing the consulting actuary’s analysis.

Is the approach used by the actuary for the audit firm appropriate?

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Case Study #7 Discussion

- Option (a) – You have a public responsibility; to ignore the deficiency is not acting with integrity
 - Integrity – (Precept 1)
 - Cooperation – An attempt was made to discuss differences with the opining actuary (Precept 10)
 - ASOPs and possible violations (#36 statements of actuarial opinion; #43 unpaid claim estimates; Precept 13)
- Option (b) – Report your findings to company and regulators
 - Courtesy – The auditor’s actuary should communicate his findings to the company (Precept 4) but criticizing the other actuary likely violates the courtesy portion of Precept 10
 - Reporting to the regulator may be a violation of Precept 9

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Courtesy and Cooperation



► PRECEPT 10:

An Actuary shall perform Actuarial Services with courtesy and professional respect and shall cooperate with others in the Principal's interest.

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Case Study #8 – “Rate Hearing”

A recent rate filing of yours went to hearing. During the hearing, the Department's Actuary (FCAS) made several misrepresentations of the data and suggested several alternatives that are in conflict with the Statement of Principles on Ratemaking and with certain Actuarial Standards of Practice.

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Case Study #8 Discussion

- Option (a) – Do nothing
 - Violations of the Code – (Precept 13)
 - ASOPs – Ratemaking (#12, #13, #20, #29, #30 and #39) or Expert Testimony (#17)
- Option (b) – Report to the ABCD
 - This may be reasonable if you have already tried to discuss the situation with the department actuary (Precepts 13 and 14)
 - You must have a strong conviction that Precept 1 has been violated
- Option (c) – Talk to the regulator
 - Reporting to the regulator may be a violation of Precept 9

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Violations of the Code of Professional Conduct

▶ PRECEPT 13:

An Actuary with knowledge of an apparent, unresolved, material violation of the Code by another Actuary should consider discussing the situation with the other Actuary and attempt to resolve the apparent violation. If such discussion is not attempted or is not successful, the Actuary shall disclose such violation to the appropriate counseling and discipline body of the profession, except where the disclosure would be contrary to Law or would divulge Confidential Information.

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Canadian Rules of Professional Conduct

▶ The Rules of Professional Conduct in Canada require that certain procedures must be followed when a member is aware of a violation of the Rules.

- Affirmative responsibility to act to correct violation
- No confidentiality agreement or employment protections exist



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Violations of the Code of Professional Conduct

▶ PRECEPT 14:

An Actuary shall respond promptly, truthfully, and fully to any request for information by, and cooperate fully with, an appropriate counseling and disciplinary body of the profession in connection with any disciplinary, counseling or other proceeding of such body relating to the Code. The Actuary's responsibility to respond shall be subject to applicable restrictions on Confidential Information and those imposed by Law.

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Case Study#9 – “Material Reserves”

You are the chief actuary for a large commercial lines insurance company. It is year-end 2008, and the losses from the soft-market years of 2003-2006 are starting to materialize, but due to the slow emergence patterns of much of the business, your reserve indications have a +/- 10% range. However, due to the reserve charge your company took the prior year due to catastrophes, even a +5% deviation from the point estimate will dangerously deplete the company surplus. What do you do?

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Case Study #9 Discussion

- ▶ Option (a) – Create a central estimate only
 - Violations of the Code – (Precept 13)
 - There is no ASOP that requires that a range of estimates be developed
- ▶ Option (b) – Provide a point estimate and a range to management
 - Due to the sensitivity of variation in reserves, management should be informed of the potential impact on financial results. (ASOP 43 and Precept 4)
 - If you are the opining actuary, it is important for you to understand management's decision on the booked reserves and how that relates to your estimates (ASOP 36)

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ASOP#43: Property/Casualty Unpaid Claim Estimates

- ▶ Specifically targets unpaid claim estimates
 - CAS Statement of Principles being revised to exclude guidance language more appropriate for an ASOP
 - Applies to all classes of entities (e.g., self-insureds, reinsurers, insurers and governmental agencies)
 - Defines the difference between claim estimates and reserves

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ASOP#43: Property/Casualty Unpaid Claim Estimates (Cont'd)

- ▶ Must specify the purpose of the estimates
- ▶ Must communicate constraints on analysis
 - Limited or no data
 - Limited time or resources
- ▶ Must identify the scope of the estimate
 - Central estimate, high, low, median, etc. (“best estimate” or “actuarial estimate” are not sufficient)
 - Is the estimate appropriate for the intended purpose
 - Specify other attributes of the estimate (e.g., discounted, net or gross of recoveries and reinsurance)
- ▶ Materiality

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ASOP#36: Statements of Opinion P/C Loss and LAE Reserves

- ▶ Guidance for *written* statements of opinion
- ▶ Applies to insurance cos, reinsurance cos and other P/C Risk Financing systems
 - Such as Self-Insurance
- ▶ Applies to practices that relate to the principles presented in the Reserving Statement of Principles Document

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Other Code of Conduct Precepts

- ▶ #2 – Qualification Standards
- ▶ #6 – Communications and Disclosure (compensation disclosure)
- ▶ #7 – Conflict of Interest
- ▶ #11 – Advertising
- ▶ #12 – Titles and Designations

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Other ASOPs not mentioned

- ▶ #20 Discounting Reserves
- ▶ #38 Using Models outside your area of expertise
- ▶ #25 Credibility
- ▶ #17 Expert Testimony

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Applicability Guidelines

ASOPs that apply to all practice areas

- 23 Data Quality, 41 Communications, 9 Documentation & Disclosure
- ▶ Reserving ASOPs
 - 20, 36, 43
- ▶ Ratemaking ASOPs
 - 13, 29, 30, 39
- ▶ Other Key ASOPs
 - 12, 17, 25, 38

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Common Allegations Received by ABCD

Alleged Violation	Number Disposed or in Process (2005)	Number Disposed or in Process (2006)	Precept
Failure to act with integrity	19	18	1
Calculation or data errors	7	2	1
Failure to perform services with competence	3	3	1
Other errors in work	3	3	1
Work fails to satisfy ASOP	3	3	3
Improper reserve estimate for insurer	3	0	3
Use of unreasonable assumptions	3	1	3
Failure to cooperate with other actuary	3	3	10

Source: ABCD 2005 and 2006 Annual Reports

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Questions?
