Professional Standards in Practice

CAS Annual Meeting
November, 2004

Moderator: **Dave Otto, FCAS, MAAA**

Panelists: **Kevin Dyke, FCAS, MAAA**
Steve Armstrong, FCAS, MAAA

Purpose of Session

- To increase awareness of the applicability of the Code of Professional Conduct to the day-to-day work of actuaries; by means of case study discussions
- To better understand the guidance the Code provides the actuary in professional and ethical situations he/she encounters.

How We'll Get There

•Brief Introduction

•Review of our Guideposts

•Short Case Studies ("Snappers")

But first, consider this situation:

You are an Associate (ACAS) in the ratemaking department of an insurance company assigned to put together an automobile rate filing. Your analysis results in an overall rate indication of +5.0%. Your boss, a Fellow (FCAS), reviews your work and says that management wants a 5.0% *decrease* and asks you to change some assumptions that will get the management-desired rate decrease. You think these changes, while individually not "wrong", are somewhat arbitrary; you feel that they result in a rate indication that is at, if not below, the very low end of a reasonable range. Your boss is the only actuary signing the rate filing report.

What do you do?

Introduction:
Increased Scrutiny of Actuaries

- "To date, at least fifty [legal] actions have been filed against actuaries, with over 70% coming in the last decade." Mealey's Litigation Report, August 2002.
- ABCD received 9 cases regarding conduct and practice in 2003.
- Recent high-profile insurance failures:
  - Legion
  - Unicover
  - PIE
  - Reliance
  - Fremont
  - ???

Introduction:
Upholding the Reputation of the Profession

- Enron and Arthur Andersen
  - Collapse of Arthur Andersen
    - Enron was less than a fraction of one percent of Andersen's fees.
    - Over 85,000 employees worldwide.
  - Public Company Accounting Oversight Board
    - "...would replace a largely self-regulating system for the accounting profession."
    - Congress gave the board authority to subpoena and discipline accountants, up to revoking their licenses to practice.

Introduction:

Upholding the Reputation of the Profession

- Pension Actuaries and ERISA
  - Studebaker Corporation
    - Oldest major auto producer in the US
    - Shut down US operations in 1963
    - Pension plan covered 11,000 employees
    - Severely under-funded pension liability
  - Other plans terminated before assets were accumulated
  - Congress stepped in with ERISA, 1974

So what’s an actuary to do?

CASUALTY ACTUARIAL SOCIETY

Code of Professional Conduct

(What is the ABCD, anyway?)

- The **A**ctuarial **B**oard for **C**ounseling and **D**iscipline "considers complaints and questions concerning possible violations of the Code…"
- It also "responds to inquiries by actuaries concerning their professional conduct and, when requested to do so, provides guidance in professional matters."

- 2002 Academy Yearbook

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.

Qualification Standards

PRECEPT 2:

- An Actuary shall perform Actuarial Services only when the Actuary is qualified to do so on the basis of basic and continuing education and experience and only when the Actuary satisfies applicable qualification standards.

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

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.

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.

Communications and Disclosure

PRECEPT 6:

- An Actuary shall make appropriate and timely disclosure to a present or prospective Principal of the sources of all direct and indirect material compensation that the Actuary or the Actuary's firm has received, or may receive, from another party in relation to an assignment for which the Actuary has provided, or will provide, Actuarial Services for that Principal. The disclosure of sources of material compensation that the Actuary's firm has received, or may receive, is limited to those sources known to, or reasonably ascertainable by, the Actuary.

Conflict of Interest

PRECEPT 7:

- An Actuary shall not knowingly perform Actuarial Services involving an actual or potential conflict of interest unless:
  - the Actuary’s ability to act fairly is unimpaired;
  - there has been disclosure of the conflict to all present and known prospective Principals whose interests would be affected by the conflict; and
  - all such Principals have expressly agreed to the performance of the Actuarial Services by the Actuary.

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.

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.

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.

Advertising

PRECEPT 11:

- An Actuary shall not engage in any advertising or business solicitation activities with respect to Actuarial Services that the Actuary knows or should know are false or misleading.

Titles and Designations

PRECEPT 12:

- An Actuary shall make use of membership titles and designations of a Recognized Actuarial Organization only in a manner that conforms to the practices authorized by that organization.

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.

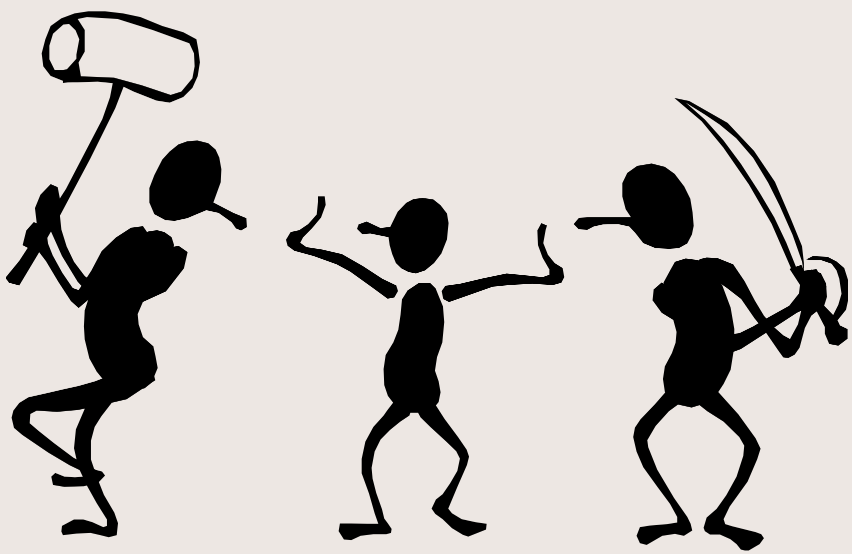
Violations of the Code of Professional Conduct

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.

“SNAPPERS”

(Audience Participation Requested)



Snappers Overview

- Snappers = Real Life Predicament
  - What should you do?
    - Kevin = Mr. By-the-book = Follow the Code!
    - Steve = Mr. Businessman = Get the job done!
- Ground Rules
  - Role-Playing – We are not expressing our own personal views or those of our employers.
  - Audience Participation – Snappers are designed to spark discussion.

SNAPPER #1

You are an Associate (ACAS) in the ratemaking department of an insurance company assigned to put together an automobile rate filing. Your analysis results in an overall rate indication of +5.0%. Your boss, a Fellow (FCAS), reviews your work and says that management wants a 5.0% *decrease* and asks you to change some assumptions that will get the management-desired rate decrease. You think these changes, while individually not “wrong”, are somewhat arbitrary; you feel that they result in a rate indication that is at, if not below, the very low end of a reasonable range. Your boss is the only actuary signing the rate filing report. What do you do?

SNAPPER #2

ABC Insurance Company retains Will, a consulting actuary, to perform the year-end review of the company's loss reserves. ABC also hires XYZ Firm to do the year-end audit review of the company's financial statements. Will issues an “unqualified” Statement of Actuarial Opinion. However, Sarah, an actuary with XYZ Firm, finds a deficiency when she performs her loss reserve review, and XYZ firm will not sign off on ABC Insurance Company’s financial statements.

Discussions between Will and Sarah become heated. Eventually, Sarah issues a statement to the company, as well as to the regulators, which criticizes Will's analysis and the “unqualified” Statement of Actuarial Opinion.

Is Sarah’s approach to the situation appropriate?

SNAPPER #3

You are doing the final review of a personal auto rate filing in a state/province when you discover a calculation error that not only was made in this filing, but also the prior filing which was fully implemented in this “Use & File” state. Your prior indication was 12% (which includes the calculation error), and you implemented the entire indication. Had this error been found, the corrected indication would have been 2.5%. What do you do now?

SNAPPER #3a

What if the state/province is really a prior approval state, and the prior filing had been approved. Now what would you do?

SNAPPER #4

The chief actuary for CT Insurance Co. estimates reserve needs at 100 (best estimate) with a range of reasonable estimates of 95 to105. The independent outside actuary appointed by the board for the reserve opinion estimates the reserve needs at 100 with a range of 94 to106.

If the company books reserves at 95, or 5 below the best estimate of both the chief actuary and the appointed actuary, should the appointed actuary provide an unqualified opinion on the these reserves?

SNAPPER #5

You are a regulatory actuary. You have received a company’s rate filing for a 13% rate increase. Your staff has analyzed the data and has convinced you that even a 15% increase is justified, based strictly on actuarial principles. Your boss, the Deputy Insurance Commissioner, tells you this will be unacceptable & asks you to persuade the company to take no more than a 7% increase. What should you do?

SNAPPER #6

- Suppose your marketing department is really pushing a new business discount in order to get a boost in growth. You have no actuarial support for the discount because you do not collect data on it. The competition does not have this discount either. As an actuary, would you file a discount that has no known support? What would you do?

SNAPPER #7

You are the actuary for a reinsurance company trying to set an excess reinsurance rate for a small domestic company that writes a specialty class commercial auto but does not have credible data. You also reinsure a larger company, which writes basically the same business in the same state, and who has supplied you with ample data that could be used to set the rates for the smaller company. Do you use the data, as a collateral source, to develop rates for the smaller company?

SNAPPER #8

- Assume that you filed a rate change of +10% and it is sitting in the Department of Insurance for quite a while (Prior Approval state/province). A new analyst decides to run a more current indication which utilizes two additional quarters of data that is not included in the 10% change waiting for approval. This new indication shows a 0.0% need. The new analyst shares this information with you and you have seen the answer. What do you do?

SNAPPER #9

- You are the chief actuary (a Fellow) for a large commercial lines insurance company. It is year-end 2002, and the losses from the soft-market years of 1997-2000 are starting to materialize, but due to the slow emergence patterns of much the business, your reserve indications have a +/- 10% range. However, due to the reserve charge your company took the prior year for the WTC event, even a +5% deviation from the point estimate will dangerously deplete the company surplus.
- What is your course of action?

SNAPPER #10

- It is discovered that there is a mistake in how your system has programmed the qualifications for a discount. The rules followed what was intended but the actual application does not match. The unintended systems error favors the insureds so refunds are not required. Do you notify the Department of Insurance that there has been an error and it is being fixed? Is the answer different if the state is Prior Approval, File & Use or No File?