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PROFESSIONAL CONDUCT AND INDEPENDENCE OF THE ACTUARY

Moderator: WAID J. DAVIDSON, JR. Panelists: EDWARD H. FRIEND, JAMES W. KEMBLE, H. RAYMOND STRONG.*

1. Exposure draft of report by Joint Committee on Independence of the Actuary.

2. Special problems related to self-protection, professional criticism, and follow-on business.

3. The actuary's relation with and/or control of the actuary by other professions and entities.

4. Evolution and current forces--effects on professional conduct and discipline.

MR. H. RAYMOND STRONG*: My remarks are aimed primarily at the third and fourth topics on the agenda. I want to raise two questions, the answers to which I once thought I knew. Now, I am not so sure.

The first question is, "To what extent should competition among consulting actuaries be condoned by the profession?" The second is, "Why should the Actuarial Profession not become a part, or branch, or specialty of the Accounting Profession?" While the first question may appear to be of interest to consultants only, I submit that the degree of "professionalism" evidenced by consultants may affect the esteem in which all actuaries are held.

When I first started in consulting work, there were only a handful of consulting actuaries in the State of Texas and they were all rather well known to each other. While it is true that business was relatively plentiful in those days, I prefer to think that the high degree of professional courtesy I saw among those practitioners resulted more from the high regard each actuary had for the others than from any surplus of business. Here are some examples of what I am talking about:

1. Consultant A, on being called by a known client of Consultant B to do a job, would call Consultant B to see if he knew about it and if he approved. This, at least, gave B a chance to mend his fences. I know of some instances where A simply declined the job.

2. We would not hire each other's employees without the knowledge and approval of the previous employer.

3. We did not solicit business, period! Maybe it was because we did not need to.

4. We did not advertise.

5. Some even refused to make a bid on a job, even when asked.

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This was before (and after) the days of Guides to Professional Conduct. Most of us subsequently modified our attitudes toward solicitation, at least with respect to pension business, and one of the earliest guides for consultants (The Conference of Actuaries in Public Practice, code of Professional Ethics adopted in 1960) permitted "direct solicitation" when "performed by himself or another actuary." It did not say anything about indirect solicitation, but I think the intention was to prohibit the use of conscious and planned indirect solicitation.

By way of contrast, we currently see instances of:

1. Suggestions by accountants that a client should change consulting actuaries, usually to a firm owned by the accounting firm.

2. Frequent hiring by actuarial firms and insurance companies of employees of other actuarial firms and insurance companies usually through an intermediary.

3. Constant and even agressive solicitation of business by:

   a. Insurance and pension salesmen who employ actuaries,
   b. Pension salesmen employed by actuarial firms,
   c. Accountants who employ actuaries, and
   d. Actuaries themselves.

4. Advertising by means of:

   a. So-called "cards" in periodicals,
   b. Newsletters,
   c. Announcements, or
   d. Lengthy and attractive ads for pension business by salesmen who employ actuaries.

5. Competitive bidding, usually when asked.

I do not say that all of these current practices are bad. And those that are bad can seldom be proved. For example, what client, having been "twisted" by whatever means is going to appear as a witness against his new adviser? Even in those cases when the "twisting" is unsuccessful, the client invariably makes the attempt known to his consultant somewhat as follows, "Do not use my name, but so-and-so is trying to get your business."

What I do say is that Guides to Professional Conduct should be enforceable, and should be enforced vigorously if a professional activity is to remain "professional" in the most desireable sense.

Now, to the second question, "Why should the Actuarial Profession not become a part, a branch, or a specialty of the Accounting Profession?" I suspect your immediate reaction to this question, as mine, is to say, "No way!" But consider a moment:

1. How successful were the actuaries in getting their views adopted in the Audit Guide for Life Insurance Companies? Not at all, when considered from the standpoint of responsibility. Maybe you are satisfied that this is as it should be, but the fact is that the actuaries failed to convince the powers that be that qualified actuaries should be relied upon for an opinion as to actuarial calculations.

2. I understand the results are not yet available with respect to the Guide for Auditing Pension Plans. I have seen a questionnaire prepared by one of the accounting firms for use when examining a defined benefit plan with an introductory sentence saying, "Its purpose is to assist members of the staff in the determination of the reasonableness of the actuarial assumptions and methods employed."

3. Consider also an ethics ruling by the AICPA, the exposure draft of which reads as follows:

   "Q. If a member's firm renders actuarial services to a client, may the member also express an opinion on the client's financial statements?" I might say parenthetically here that this question was raised by the actuaries who are members of the Actuaries Committee on Relations with Accountants.

   "A. Even though the member's firm provides actuarial services (the results of which are incorporated in the client's financial statements), if all of the significant matters of judgment involved are determined or approved by the client and the client is in a position to have an informed judgment on the results, the member's independence would not be impaired by such activities."

   I have since learned that that interpretation of the ethics ruling has been adopted by the AICPA.

4. I would call your attention to the fact that there are some 30,000 CPAs in the United States and that qualified actuaries probably number less than 5,000.

5. I recently saw a position listing by the referral service of the Society of Actuaries which says that one accounting firm has an actuarial staff of some 40 actuaries, 13 of whom hold partnerships in the firm, which means that these 13 are also CPAs.

6. I attended a dinner meeting earlier this year for a group of actuaries and accountants. I was seated next to an accountant who holds a highly respected position in his profession. During the course of the dinner conversation, he informed me, in a very matter-of-fact way and without trying to appear smart or funny, that he expected the actuarial and accounting professions to be one within a few years.

Please recall that I did not propose to give answers to the two questions I have raised. Now, I would like to raise another question: Has the time come for actuaries to heed the old admonition, "If you can't lick 'em, join 'em!"? Should the Guides to Professional Conduct, or the interpretations thereof, be amended to recognize a state of active competition among consultants, and should actuaries initiate talks with accountants concerning merger? If not, what can be done to reverse the trend?

MR. EDWARD H. FRIEND: I was quite interested in Ray's comments. I must say I don't totally share his concern about the actuarial profession being absorbed by the accounting profession so long as we maintain the standards which we believe in and avoid getting into the kinds of practices which would further that kind of merging of the professions.

I wanted to begin my remarks by making it absolutely clear that the efforts of the Joint Committee on Independence are not aimed at self-preservation but at self-elevation. On April 23rd our committee met for, hopefully, the last time, the fourth time I might add over a period of two years. The meetings were followed by much correspondence, many telephone calls, much dialogue, many differences of opinion, and many hours of deep thought. During these meetings we have produced two exposure drafts.

We talked and we developed and we produced, hopefully, in our final meeting on April 23rd the final reexamination of our position resulting from hearing what you out there have had to say and people from the accounting profession have had to say. We have listened to every observation and tried to be very self-critical. I must say in certain areas the final decisions of the committee were not necessarily those with which I fully subscribed. But that is the democratic process and I think the weight of the deep considerations have led to a final conclusion that is going to be very valuable. I would like to just touch briefly on the major thrust of the final position. It is not much different from that position which you read about in the second exposure draft.

If an actuary prepares for the public (an outside user of the actuary's work) a written report, opinion letter, calculation, annual statement or other work product, that work product may or may not be subject to written confirmation. Let's examine for the moment the "not," particularly in the insurance industry. That work is often accepted without written confirmation, except perhaps by an Insurance Department, which is essentially a public watchdog agency. It is accepted because that publicly presented work of the actuary is regarded as the work of a professional who is subject to rigorous standards of ethics and behavior governed by a challenging set of Guides to Professional Conduct. We subscribe to that kind of high regard by the public and our committee's work attempts to bolster that kind of acceptance through promoting further professionalism and through encouraging requirements for more disclosure. We subscribe to the principle of the non-need for a so-called audit of the professional actuary's work.

If, however, the publicly reported work of an actuary is to be confirmed for that public, that is, for the purpose of giving comfort or assurance as to its accuracy or correctness, whether by another actuary or by an accountant, it is the committee's position that the other actuary or accountant must be independent of the entity with respect to which the report is rendered and must be independent of the preparer of the original work product. This is true whether the confirming actuary or accountant actually reviews the work or simply establishes that the original actuary is qualified and competent. When the work of an actuary is to be confirmed for the public record, whether by review of his work or by establishing his qualifications and competence, or whether or not that reviewer is waiving that review of establishment of competence, it is up to the actuary to see that this confirming party is independent of him. Failure for him to do so would be a violation of proper professional conduct.

Some people have said that the joint committee is addressing itself to the accounting profession and laying down rules of conduct for it. This is not the case. The joint committee is concerned about the behavior of its own professional actuaries. What we are saying is that the failure of the actuary to perceive a proper relationship between himself and that person who is auditing him is a breach of proper professional conduct.

In order to encourage public acceptance of an actuary's work which need not be subject to audit confirmation, the committee will recommend strengthened disclosure requirements and professionalism. The actuary will be expected to disclose his relationship to the entity for which he does his work; that he is the Chief Actuary, for example, of an insurance company, or that he is the Pension Actuary for the company that is the sponsor of the multi-employer plan. This disclosure would give the public an opportunity to say, "Now wait a minute, the appearance is bad here. Even though we respect his professionalism, let's see to it that we get an actuary who does not have this kind of affiliation." The public is entitled to that disclosure.

The joint committee believes that when an actuary solves for the assumptions leading to a preconceived conclusion, this must be disclosed. It may be that those assumptions are within the bounds that he might choose in any event. But the very fact that he has had to go back and find the assumptions that would produce the results is deemed to be a disclosable act. Illustration: You have a client who says to you as a Pension Actuary that he is interested in putting in 7% of his wages into his pension plan and he would like you to confirm that requirement. You solve for the assumptions which lead to that result and this set of assumptions may or may not be assumptions which you would have chosen on your own. This is a disclosable piece of information. The position of the joint committee is that it would tend to stop that kind of pressure--pressure which is demeaning to the actuary's overall work product.

The joint committee would also require that all actuarial work products be signed. Now, this is one of the things that the committee recognizes as not enforceable. If we are actuaries for insurance companies, management takes our work and puts it out along with many other things and we are not associated with that work product. But if more and more actuarial work is put out under signature of the actuary, then any actuarial work product that comes out without that signature will eventually be deemed to be less than up to standard. It is the hope of this committee that eventually this will be something that can be mandated.

Finally, the committee takes the position that there must be strong enforcement of the Guides to Professional Conduct if the public is going to accept the work of the actuary as work that can be relied upon without audit. There must be dissemination of information about offenders and we should know what is being done when somebody is not behaving properly. It is not necessary to identify who the offender was, what is important is what was done that was offensive, what were the sanctions that were delivered, and what changes were made as a result of this event.

Certain items in the second exposure draft were changed as a result of the committee's work. Probably the most important one is in the area of sanctions. In the earlier draft, the joint committee took the position that, if an actuary is affiliated with a firm which violates the prohibition against self-audit

and he calls this to the attention of management of that firm and management intends to continue the practice, then the actuary must disaffiliate himself from the firm. The committee believes that this kind of action is still probably the correct action, but it will turn over to the Professional Conduct Committee the implementation of whatever actions are required. You have told us that you believe this is outside of our purview. We have heard you and we have accepted that position, and are turning the sanction over to the Professional Conduct Committee, even though the position remains the same.

Another item in the second exposure draft, which relates to an actuary whose business was replaced by an actuary or firm involving actuaries where the replacement took place as a result of unfavorable criticism where no opportunity for challenge was given, was eliminated. We still support that position, but we have heard from you and have placed this matter before the Joint Committee on Professional Conduct because we believe that the replacing actuary or actuarial firm or actuarial/accounting firm is self-serving and therefore violates concepts of independence when it criticizes and withholds the criticism from the individual whose work is being criticized and then replaces him. This is a reflection of lack of independence because it is serving self as well as client. Nevertheless, we have heard from you and we are presenting this problem to the Committee on Professional Conduct.

Finally, we have dropped from our report any decision over whether or not a member of the Board of Directors of a corporation or insurance company is a member of the public. The committee was split on this subject and felt it was detracting from the main purpose of the joint committee's work. Therefore it was relegated to the cover letter and established as a problem to be considered in the future.

MR. WAID J. DAVIDSON, JR.: The subject of independence is a very complicated and important subject. One of the things that complicates it is the different areas in which the actuaries operate. Independence is a simple matter for the accountants because basically their livelihood depends on audit, audit depends on a certain image, and independence is obvious. In the actuarial profession this is not true because of our high degree of diversity.

MR. JAMES W. KEMBLE: First of all, let me say it is nice to have an opportunity to discuss this subject, where I can avoid exposing my technical frailties and I can express my opinions about something for which I have some rather strong feelings. I hope they are not biased feelings. You will note that we have three consultants on the panel. Fortunately, our areas of practice have not overlapped geographically, so differences of opinion which exist are not the product of any particular instances or confrontations between ourselves or among ourselves on the panel. Thus, if there should be differences, it is because we have an honest difference of opinion. I feel very strongly that the subject deserves a good hard public airing and this is what we're intending to do now.

With these opening remarks, let me turn to the joint committee report first of all. The charge to the committee was to draft a position paper and a set of guidelines on the circumstances, if any, under which organizational and financial independence of the actuary are desirable to avoid what may appear to be a conflict of interest in the performance of certification and other actuarial duties. At the risk of sounding a bit facetious, I might comment here that I really find myself in a dilemma after reviewing the report. On

the one hand, as a person primarily responsible for the financial well-being of our firm (which is really calling myself our number one salesman) I know the committee report is not doing anything to stimulate business for the consultant, there being no prohibition against the auditors or other public entities accepting the work of the staff actuary. On the other hand, I am told that if our firm, which means any member thereof, performs the functions normally performed by a staff actuary for a client which doesn't have one, then our joint venturee cannot audit that client's statement, at least without getting our work audited by an actuary from another firm, even though our joint venturee would in most cases be much more comfortable with our work than he would be with the work of a staff actuary or another consultant. My initial reaction is, either the committee did not go far enough with respect to the company actuary, or they went too far with respect to our type of operation. Knowing the position of our joint venturee from a practical point of view, I would have to opt for the first conclusion, because, as a matter of fact, they have stated quite emphatically to me that they do not propose to audit the work of Stennes & Associates. So, perhaps, my feeling here is more a feeling of not liking having a finger pointed at us. At any rate, from the standpoint of a person who is responsible for the operations of a consulting firm which happens to also have a joint venture operation, these are some of the practical considerations.

Actually, I guess, I would have been happiest if the committee had concluded that it is not our responsibility to determine when and to what degree independence is important. That may sound a bit strange to you at first, but let's think about it for a moment. Take, for example, a CPA firm conducting its audit of an insurance company or a pension plan. Is it not the CPA's responsibility to determine whether I am independent enough to audit this work rather than another actuary? Or, as a matter of fact, whether an actuarial audit is even required? Doesn't the same apply to a Board of Directors, security analyst, insurance commissioner, or whoever might be in a public situation where all or part of a company's reserves may be questioned or need to be reviewed? My point here is that I think the public needs to have considerable input as to when independence is required.

A further point I'd like to make is that the matter of independence is, in my opinion, of far less importance than the need for a full disclosure of the relationships and possible conflicts, plus the need for the application of a highly professional code of ethics. The committee report does indeed emphasize this and I recognize and appreciate that. I submit that, if we pay strict attention to the professional and ethical requirements of our jobs, the problem of independence will almost automatically be taken care of. I'd like to be not so concerned about the "appearance of" independence or whatever; instead I'd like to have us strive to maintain the highest level of performance at all times.

There are a couple of other points in the committee report which I would like to comment on, primarily related to the illustrations. I understand the illustrations will not be included in the final report; however, they will be part of the record and they do certainly provide much additional information on many of these things. I wonder why pension actuaries fare slightly better in cases 5 and 6 than do their insurance counterparts in cases 2 and 3. Just to refresh you, cases 2 and 3 refer to a CPA who relies on the opinion of an actuary who works for or has a joint venture or similar relationship with the CPA's firm. The illustration concludes that all actuaries in the same

actuarial or CPA firm must resign because a waiver of self-audit has occurred. From Ed's remarks, I understand we just modified this. Now he does not have to resign, but the matter is turned over to the Professional Conduct Committee.

Under cases 5 and 6,however, this will not be necessary if the CPA and all members of his firm will accept the certificate of all actuaries "with the same credentials." I doubt that as a practical matter this provides much more freedom of action to the pension actuary. I do not know of a CPA firm who would be willing to accept the work of any other professional merely because he has some initials behind his name. So the existence of the slight difference there does not concern me from a practical viewpoint but I feel there is a little inconsistency in principle.

I'd like to comment just in passing on the composition of the committee and offer a suggestion to the leaders of the various actuarial bodies who appointed representatives to it. There is not a committee member from a joint venture firm (ours is the only one I am aware of), nor from a CPA firm. These are the people with firsthand exposure to the most sensitive aspects of this problem, and I think their opinions would have been invaluable.

Now that I have expressed my reservations about the report, I want to say that I have complete respect for the integrity of the report itself and for the committee members. I have heard about the debates and conversations within the committee, and I believe an excellent job of discussing all phases of the problem was done. I am most grateful to you, Ed, and to the committee members for the time and effort you have put into it.

Point 2 in the program has to do with the subject of self-protection, professional criticism, and follow-on business. Again the committee addressed itself to this problem and has now, as I understand it, made recommendations to the Professional Conduct Committee instead of proposing sanctions in this report. It has been my impression over the past several years that one of the biggest reasons for the diminshing public confidence exhibited in professional persons has been the perception by the public that most of them are operating in an atmosphere of self-protection. The reluctance, sometimes I think bordering on refusal, of a professional to publicly criticize the work of another member of the same profession is, in my opinion, at the heart of this problem. I think any such criticism can only be justified after having given the person being criticized the opportunity to discuss the situation privately. If after such consultation, or perhaps unreasonable avoidance of discussion by the other professional or actuary, there still exists a difference of opinion, I believe it should be the obligation of both parties to make their opinions known. If as a result of such public debate, one actuary loses his client to another, so be it. In the great majority of cases the client's decision will be appropriate. By public debate I mean discussion for the benefit of the client and the public he serves. I think this is what the committee has said and means with respect to follow-on business. If so, I am in agreement with their conclusions.

The third subject covers our relations with and/or control by other professionals and entities. I see three situations here which should be discussed. First, suppose we are part of an audit team, employed by a CPA firm, a joint venturee with the CPA firm, or just through having an assignment given to us by a CPA firm to help them with their audits. I think that a prior definition of the scope of the project will help prevent many problems. This

is probably easier and more comfortable for the actuary employed by a CPA firm or joint venture firm because of the more permanent nature of his relationship and prior experience with each other. At any rate, knowing what the auditor expects from you at the outset is essential for a successful project. We have to recognize the legal obligations of the CPA. Under such circumstances he is obliged to control the audit. If we do not like how he defines our scope of the project, we do not have to accept the assignment. Admittedly, this is easier to do if you are not permanently employed by the auditor.

A second situation is where you are employed by or affiliated with a sales organization. There is a lot of debate over whether the consultant should accept a fee or whether his compensation should be sales commissions, and it is one which could go on and on. I believe that the integrity and professionalism of the individual will control this matter more than anything else.

Third, the actuary's employer is a corporation, be it an insurance company or an employer sponsor of a benefit plan. The corporation, in the final analysis, is his public. However, in a broader sense, he must consider the best interests of the policyholders of the insurance company or the employees of his employer. We have to avoid being influenced by short-range goals of the boss if they are in conflict with appropriate long-range objectives.

MR. FRIEND: I was delighted to note that Jim, who is affiliated with a joint venture actuarial/accounting situation, agrees pretty much with the conclusions of the joint committee. He has indicated that he feels it would have been preferable if the committee had left to the public the decision as to when independence is required. The committee went one step further and said, "We are going to leave to the public this decision except when there is to be a confirmation for comfort or assurance." I would be interested in asking Jim whether he could perceive of a situation in which there would be a requirement for confirmation when he would believe that independence would not be required.

MR. KEMBLE: I'm not sure that I can. I think my concern about the report is more that I feel we are, in many instances, actually allowing a waiver of self-audit. In some instances the committee has indicated that the work of an actuary be audited by someone independent, but in many instances I think we have left it open. Let's take the example of a company actuary who signs the company reserve certificate. If an auditing firm comes in and reviews this individual's work without benefit of an independent professional actuary, what is the responsibility of this company actuary who signed the reserve certificate? Should he disclose to the public that, as a matter of fact, a certain percentage of his company's liabilities were not professionally reviewed? Does he have this responsibility, or who does?

MR. FRIEND: Well, let's take a look at that situation. The actuary for an insurance company prepares an annual statement and he signs this annual statement. As part of his work he must disclose his relationship to the company; that he is the Chief Actuary, that he perhaps owns some stock in that company. Now, as we have indicated, the public may accept that original work without confirmation (it happens quite often) or the public may require an audit. Now, the joint committee's position is, to the extent that it is audited, that auditing organization or person must be independent of the actuary of the insurance company and independent of the company itself. But to the extent that the actuary's work is not audited, I think that falls outside of the responsibility of the Joint Committee on Independence.

We are not insisting, as a matter of fact we are encouraging, non-audit of a professional actuary's work because of his professionalism and disclosure. We do not think it is required in the same fashion as, for example, the internal accountant of a corporation who is not bound by the AICPA's entire raft of pronouncements. A very different set of guides of professional conduct apply to the in-house accountant as apply to the CPA in public practice. Not so in the actuarial profession. Every actuary, whether he is public or works as an employee, is bound by the same rigorous standards. It is our view that it is not necessary that this work be audited. I am not uncomfortable with the absence of an audit in this area.

MR. STRONG: May I ask a question to be answered either by Ed or Jim? Take the case of a small life insurance company that does not have its own actuarial staff being audited by an accounting firm that employs actuaries or has actuaries affiliated with it through a joint venture. Then, as I understand the ethics ruling that has come out of the AICPA, the actuary associated with the accounting firm can do the work and it does not have to be audited by an accountant. How can the actuaries' code of professional conduct approach this situation?

MR. FRIEND: The Joint Committee on Independence spent quite a bit of time on this subject. To restate, the position is taken by the AICPA that, if management has made the judgments of the actuary his own (an actuary does the work and management accepts this work and absorbs it and makes those judgments its own; the actuary no longer is involved), then the accountant is auditing management and not the actuary's work. The joint committee's position is that it is so rare that management can embrace the actuary's work as its own that this becomes kind of an empty set. There are some who feel that, in order for management to embrace the work of a consulting actuary as its own, it must have its own actuary in-house be familiar with all of the work papers leading up to the conclusions and be able to answer all questions which might be raised. Eventually then the internal actuary is preparing the information and has used the consultant merely as a means of arriving at this work and it is now the work of the management through its internal actuary and it can be audited by the firm that employs the first actuary who was consultant. This is a rare occurrence. The actuary is essentially responsible, particularly in the case of ERISA where the actuary must prepare a report and be responsible for it. This is not management's report, this is the actuary's report. For the AICPA to take the position that it becomes management's work is, in our view, not palatable because the actuary must assume responsibility and sign his work.

MR. KEMBLE: At the risk of seeming to be a little stubborn about this, this still appears to me to be more of a matter of appearances rather than really getting at the heart of the problem. You all know how independent actuaries are through experience. I hope that through the strict application of some high level professionalism and ethics we really do not have to face this problem.

I would also like to make one other comment, and I do not know if it is typical of all situations, but primarily where we are as a matter of fact the management, the staff actuary for a client. Very seldom is the "big eight" accounting firm going to be extremely anxious to become their auditor. Most companies who are small enough not to have their own staff actuary are probably small enough not to be using a big eight accounting firm. So, financially, I do not think the conflict exists nearly as much as it might appear on the surface.

MR. FRIEND: I might comment in closing this particular subject that the accounting profession is not unanimous in this ethics ruling. There are at least one or two firms in the "big eight" who completely disagree with the position of the AICPA. In addition, we understand that the Conference of Actuaries at a recent board meeting have raised the question as to whether this ruling does not put actuaries in the accounting firms who are endorsing this ruling in jeopardy of violating their Guides to Professional Conduct. This is a head-on confrontation position and I think we are going to see a resolution of this thing one way or the other. I think it is important that it was brought up here and I think we all ought to watch the way in which this ethics ruling survives or is changed.

MR. DENNIS M. POLISNER: I have a question for you, Ed. You talk about a direct confrontation position with the accounting profession. What sort of time frame do you see this coming to a head?

MR. FRIEND: Dennis, I would have great difficulty in addressing that question. We are going to be getting our report out for review by the members of our committee within the next several weeks. They must review it, give their comments, all others must see the comments and changes, and they must be reconstituted reflecting those comments and changes, and then be submitted to the various Boards of Directors of the six North American actuarial organizations which have sponsored the creation of this joint committee,and then they will probably submit these conclusions to the subcommittee for final deliberation and adoption. I would guess it is probably going to be six months before this thing is before the membership.

MR. JAMES C.H. ANDERSON: If an actuarial consulting firm is employed by a life insurance company that does not have its own actuarial staff and some member of the actuarial firm is performing the normal on-going actuarial functions, including such things as product design, then at year-end the actuarial firm certifies the company financial statement and the certifying actuary is from the same actuarial consulting firm, but not the actuary that performed the first function, does this fall into the category of self-audit? If the answer is yes, then there appears to be an inconsistency since if the same actuary did all the work it would not fall into the category of self-audit.

MR. DAVIDSON: In your example what we have is a consulting actuary who is functioning as the company actuary. What he has done is the actuarial work just as those of us who work for companies do. Then when it comes to the end of the year we also value the business and we issue an actuarial report, if you like, which states the value of this business is valued correctly. If you file an annual statement, you have a whole series of things that you certify to. There is only one statement to the public. The problem develops if you do that and then you come along and issue an additional certificate in effect stating that we have audited these statement figures.

MR. FRIEND: If there is a problem because the same person does both, then there is also a problem if two different people in the same firm do both. They are interchangeable. I do not think that the committee would view these as any different. My problem is whether that first product is a public statement. If it is, then it should not be audited by the same actuary or by someone in the same firm with the first actuary.

MR. CLAIR S. MANSON: It has been stated here that the appearance of independence is not nearly so important as actual independence and that actual independence is attained by the high ethical and professional standards that are self-imposed by each actuary. That seems to me to be an ideal solution, but I just wonder if it really is practical in the long run,for all actuaries are human beings and some small percentage will not live up to self-imposed standards.

MR. KEMBLE: That is kind of my idealistic point of view. I am ready to concede that there are practical limitations to that. But I still say and I exort everybody to say to themselves that this is really the solution to the problem. If we practice according to standards as we have in the past as a profession I think much of this debate will more or less go away.

MR. DAVIDSON: We looked into that concept at some length in our early deliberations in the Joint Committee on Independence. This was before the Equity Funding scandal. I think that Equity Funding was one of the things that caused us to rethink that particular position.

MR. KEMBLE: One of the things that I feel very strongly about and I have observed from time to time is that I feel because of my position I am being forced into more rigid standards than, let's say,the staff actuary of a life insurance company. This really is, I think, my primary difference with all of this. I would like to say that those of you who are staff actuaries should feel much more comfortable if occassionally you do have someone from the outside take a look over your shoulder.

MR. RONALD A. LABUTE: My first comment will be in regard to the control of the actuary by other professions. Under ERISA the actuary is asked to make his best estimate of anticipated future experience under the plan when he is selecting his assumptions. It appears that some other professions, particularly the accountants, do not seem to run short of experts when it comes to telling us what assumptions we should use, especially interest assumptions.

Secondly, I do not agree with Ed Friend on everything he says, but one thing he says I agree with very strongly. That is the principle of signing a report. If a report is supposed to have credence I think it is imperative that an actuary sign it. Also, I would remind everyone that actuarial certification by an individual is required under ERISA.

I personally am very concerned about the relatively easy access to the enrolled actuary status under ERISA. There are many individuals who are now enrolled actuaries who have no professional affiliation whatsoever in the Society of Actuaries, the Academy of Actuaries,or other actuarial organizations. The Academy of Actuaries has offered these individuals affiliate status. What Guides to Professional Conduct will govern the individual who is now an enrolled actuary and is not a member of any of the bodies involved today that we have been talking about.

MR. STEPHEN G. KELLISON: On the question of affiliates in the Academy and the matter of discipline, any person in the Academy who has affiliate status has to comply with the same Guides to Professional Conduct as regular members. These guides apply to all universally. Of course, all enrolled actuaries, whether they be members of an actuarial organization or not, will have to comply with the standards of practice established by the Joint Board for the

Enrollment of Actuaries in order to retain their enrollment status and not lose it. Thus, an actuary in an organization will have to comply with both sets of standards.

On the question of standards for enrollment, as you know, the enrollment process under pre-1976 standards is nearly completed. The applications are all in, and most people that are going to be enrolled have already received their notification. However, we are still very much up in the air concerning post-1975 standards. At the meeting for enrolled actuaries held in Washington, D.C. on May 14-15, Leslie Shapiro, who is the Executive Director of the Joint Board, made a surprise announcement of the proposed new regulations. Every indication is that the standards will be considerably strengthened for enrollment after January 1, 1976. How these standards will turn out in practice remains to be seen.

While I have the floor, I would like to make one additional comment on Item 3. The Department of Labor has recently promulgated a Request for Proposal (RFP) for a study of Public Employee Retirement Systems (PERS). This study was mandated by ERISA. There are a number of different firms that have indicated an interest in bidding on this RFP. Some are actuarial firms, some are accounting firms, and some are neither. The RFP, as amended, is virtually 100% actuarial in content. I think we would all agree that it is important that the Academy take a strong position to the effect that actuarial work must be done by qualified actuaries. There is also a question of whether we should go further. For example, an accounting firm or other nonactuarial firm might perform this study using the services of qualified actuaries. However, many actuaries would be disturbed by the result that the study is publicly attributed to this other firm and no mention of the actuarial involvement appears. This is particularly significant in the PERS study, since it involves a topic receiving a lot of publicity at the present time.