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Ethical Decision-Making for Actuaries: Part 2

By Frank Grossman

Veteran actuaries know there's a world of difference between what works in theory and what succeeds in practice. Part 1 of "Ethical Decision-Making for Actuaries"[1] approached its subject in somewhat abstract terms by referring to the pervasive gray of the ethical plane, the Trolley Problem thought experiment, and the pitfall of strict utilitarianism. This second article focuses on practical issues confronting ethical decision makers and offers some possible solutions.

1. CONVENTIONAL APPROACHES

Corporate ethics training often relies on a step-wise approach to ethical decision-making. Here's a typical four-stage example:

> **1. Seek greater awareness** – The decision maker is encouraged to obtain more "facts" about the situation faced. Admittedly, the situation may be ambiguous or complex, without clear or good options, at the outset.
>
> **2. Try to understand the situation better by asking questions** – Could one's actions violate the law or corporate policies? It's important to recognize that the minimum requirements of relevant laws and regulations may present a very low standard, and that reputational risk may exist even when staying on the right side of the law. Might one's actions create a situation where others feel they are owed something, or that they are obligated to the decision maker somehow? Hence, could one's actions appear to be improper?
>
> **3. Review possible options** – This includes reaching out to others if possible, and evaluating trade-offs.
>
> **4. Make an ethical decision**

While this framework isn't much better or worse than most, its efficacy should not be taken for granted. A basic concern is not how corporate ethical training *seems* to be working but, rather, how well is it *actually* working? In particular, it's the perceptual elements of ethics training that are suspect:

- How does one become more aware?
- What are the "facts"?
- What might others think?

Organizations are investing significant resources into improving their "ethicality" via internal policies and guidelines, codes of conduct, compliance officers and ethics training. Some of these initiatives have been mandated by law, like Sarbanes-Oxley. What's clear, generally speaking, is that these efforts are expensive—and if they worked they might be money well spent. Yet "bad acts" continue to surface in the media and the courts. What remains unknown, however, are the quantum of ethical transgressions that lie beyond public view—iceberg-like—beneath the surface, and their deleterious influence on business and social interactions.

2. EMPIRICISTS ASCENDANT

Human perception and how it influences ethical decision-making has been at the forefront of the emerging field of "experimental philosophy." Philosophers, who in the past rarely collected data, are now getting up from their armchairs to learn what other people think about their thought experiments. This search for an empirical foundation is akin to the revolution in microeconomics, namely behavioral economics, that has taken place over the past 30 years. And what's new is that technology is enabling better experimental design, thereby expanding the range of statistical inquiry into ethical issues.

Whether we view an action as being ethical largely depends on whether we think that it was intentional or not, and armchair philosophers have weighed in on this topic for centuries. Here's a recent thought experiment formulated by Joshua Knobe targeting the influence of "perceived intent" on one's ethical opinion of others:

> **Seeking More Profits**—Suppose the CEO of a company has to decide whether to adopt a new program. It would increase profits and

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help the environment too. "I don't care at all about helping the environment," the CEO says. "I just want to make as much profit as I can. Let's start the new program." Would you say the CEO intended to help the environment?

During a session at the 2011 SOA Health Meeting, less than 2 percent of the attendees said yes:

Table 1: Seeking More Profits

Did the CEO intend to help the environment?			
Yes	No	?	Total
2	104	6	112
1.8%	92.8%	5.4%	100.0%

The follow-on thought experiment is similar, but its environmental impact is different:

> **Still Seeking More Profits—**The same situation as before, but this time the program would harm the environment. The CEO, who still couldn't care less about the environment, authorizes the program in order to improve profits. As expected, the bottom line improves, and the environment suffers. Would you say the CEO intended to harm the environment?

This time more than 22 percent of session attendees said yes:

Table 2: Still Seeking More Profits

Did the CEO intend to harm the environment?			
Yes	No	?	Total
25	80	7	112
22.3%	71.4%	6.3%	100.0%

The direction of the shift in opinions expressed during the Health Meeting session, a 20 percent swing (from roughly 2 to 22 percent), was consistent with Knobe's results, even though the absolute levels of support differed.[2]

This so-called "Knobe Effect" suggests that observers may not decide whether an action was intentional until they learn whether it led to a good or bad outcome. Hence, people tend to "back-in" to their view regarding intent—and ethicality—only after the outcome of a decision is known.

3. ETHICAL FADING

Max Bazerman and Ann Tenbrunsel[3] are experimental philosophers. Their findings suggest that ethics rules are bent or at times broken in the workplace because those in charge are often blind to unethical behavior, and may even unwittingly encourage it. Unfortunately, such cognitive biases and institutional barriers have the potential to more than offset the otherwise beneficial influence of ethics training and compliance programs.

Cost-benefit analysis, for example, often fails to deliver an ethical outcome because its ethical dimension was simply not considered. Bazerman & Tenbrunsel refer to situations where ethical considerations fall outside the scope of the analysis, and are relegated to being mere externalities, as "ethical fading." The institutional details and the distractions of everyday work life can lead managers to fail to see the ethical consequences of their decisions.

Actuarial analyses are often subject to ethical risk. Greater uncertainty about actuarial outcomes—in terms of what they comprise, their likelihood and their ethical impact—can increase the chance of an unethical choice being made. And because the time horizon of some actuarial projections can extend for many years into the future, this can contribute additional uncertainty to the analysis and hence more risk of ethical fading.

4. UNINTENDED CONSEQUENCES

Another obstacle to ethical decision-making identified by Bazerman & Tenbrunsel is "unintended consequences." This is a fairly recent term used to describe the unraveling of an outcome (usually in a bad way) after a decision has been made. What's not quite clear, however, is whether unintended consequences are a genuine surprise to decision-makers, or simply a blunt rebuttal of their unduly optimistic or even wishful thinking. Unintended consequences are sometimes accompanied by a "How was I sup-

posed to know that could happen?" observation by the decision-maker. Whether this constitutes an acceptable reason or merely an excuse (or perhaps a little of each) for a poor ethical decision is open to debate.

5. MOTIVATED BLINDNESS

The act of overlooking information, when it is in one's interest to remain ignorant, is described by Bazerman & Tenbrunsel as "motivated blindness." Motivated blindness can be due to decision-maker apprehension, misaligned incentives, organizational loyalty or other cultural norms. Not surprisingly, motivated blindness can also arise from a basic conflict of interest.

A recent example from the news involved credit rating agencies that went on the record and repeatedly asserted that their appraisals of CDOs and other financial instruments were not influenced by fee income received from the rated entities. Choosing to "note and disclose" that such a situation exists is a possible solution. But third-party awareness of a possible conflict, by itself, does not eliminate its potential influence on the decision-making process.

Peer review represents a potential opportunity for motivated blindness. This may seem surprising, especially as peer review is generally thought to be a good thing. In principle, peer review is undertaken to improve the quality of actuarial work product by obtaining feedback from another actuary. Such feedback transcends informal conversation by the water-cooler, and can result in a formal written review.

Peer review has obvious benefits, including an exchange of perspectives, identification of alternate actuarial approaches and clarification of the communication of the work product. Yet, in its strictest sense, such a review is not completely independent if undertaken by one's immediate peers, actuaries who work for the same organization. Indeed, motivated blindness may influence reviewers closest to the work product—those who would potentially have the most to contribute by offering candid feedback. Once again, simply disclosing that there is some lack of independence may alert the user, but it doesn't necessarily enhance the stringency or quality of the peer review.

The American Academy of Actuaries published a helpful discussion paper, *Peer Review: Concepts on Professionalism* (2005) addressing some of these issues. In principle, when seeking a peer reviewer, "… one would normally look for three traits … (i)ndependence from the work product being reviewed … (e)xpertise … (and i)ndependence from the preparing actuary …" The discussion paper then offers some practical advice:

> When selecting a peer reviewer, the preparing actuary may choose to consider how independent and skilled possible candidates are, striking an appropriate balance to attain the desired level and type of review that, in the preparing actuary's professional opinion, will provide useful support to the preparing actuary, in completing the final work product version released to the user.

In a similar vein, the Canadian Institute of Actuaries' *Consolidated Standards of Practice* (§1640.14) makes a nuanced point (emphasis added): "The *perceived* objectivity of the reviewer is enhanced if the reviewer is independent of the first actuary."

Cost may also influence motivated blindness. For example, it's a small step from "If we paid an external actuary to undertake a peer review, then its cost would very likely exceed its anticipated benefit" to concluding that a peer review is too expensive before knowing what it might say. So, how much should a peer review cost? Or, perhaps, what's peace of mind worth to an actuary—bearing in mind The Ed Lew Rule[4] mentioned previously?

6. SLIPPERY SLOPES

Bazerman & Tenbrunsel also note that we are more likely to accept ethical lapses, so long as each successive breach is only incrementally larger than the preceding one. Hence, abiding minor ethical infrac-

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tions inevitably has a signaling effect, and promotes the familiar slippery slope syndrome whereby individuals become progressively inured to poor ethical behavior. The obvious antidote is to adopt a vigilant attitude toward even seemingly minor ethical lapses.

7. OUTCOME BIAS

Organizations tend to exhibit an outcome bias by rewarding positive results rather than high-quality decisions. After all, everybody likes a winner—even if, for example, an athlete sets a world record with the help of a "pill." Hence, a poor decision that results in a good outcome may be rewarded, while a poor outcome stemming from a good decision may very well be punished. If this sounds like "means and ends" once more, it is.

It might be worth noting that our criminal laws, in a similar manner, often punish bad outcomes more severely than foul intentions. For example, Tom points a gun at Harry, shoots to kill, misses, and Harry survives (good). Dick, in turn, points a gun at Harry to scare him, the gun goes off accidentally, killing Harry (not so good). Dick can expect to receive a much more severe sentence than Tom.

Bazerman & Tenbrunsel suggest that what's frequently missed by managers is a thorough *ex post* analysis of the consequences of a poor decision (that happened to turn out well) under alternate "less lucky" circumstances. Unfortunately, such analysis risks being viewed as nitpicking or unproductive second-guessing, and contrary to much of contemporary corporate culture. The solution is to recognize the human tendency to reward success "at any price," and factor in some reward for quality decisions too.

8. COUNTER MEASURES

Organizational change can be difficult, but safeguarding or somehow reinforcing the "ethicality" of our behavior seems especially daunting. Bazerman & Tenbrunsel emphasize that a key part of the change prescription for individuals is aligning their "should" and "would" self-views.

Generally speaking, we tend to predict that we will behave as we "should" behave, but at the time of decision we instead revert to how we "want" to act. In retrospect, however, we tend to believe that we actually behaved as we thought we "should" have. Due to our unconscious biases, both i) our predictions about how we will behave, and ii) our reflections on how we actually behaved, are frequently unreliable—and our ethical decision quality suffers thereby. More than 300 years ago, François duc de La Rouchefoucauld similarly observed how theory can fail to translate into practice at the point of contact: "Philosophy easily triumphs over past ills and ills to come, but present ills triumph over philosophy."

How can we increase our self-awareness, and move closer to our ideal "should" ethical self-image? Bazerman & Tenbrunzel suggest that this may best be done by deliberately tackling our cognitive biases before, during, and after making decisions.

Prior to making decisions – One way to prepare for the influence of the "want" self is to anticipate the adverse motivations that are likely to influence you at the time you make a decision. This doesn't mean simply acknowledging that you will be influenced by self-interest, but to prepare to withstand its influence (akin to visualization techniques).

Publicly locking-in a pre-commitment to a particular course of action can help, perhaps via a written statement of intent. You can also share your "should" ethical action with an unbiased individual whose opinion you respect. This person could be a mentor, but in any case needs to be someone with the wherewithal to understand the actuarial aspects, and implications, of your situation.

When making decisions – The influence of abstract thinking is often far less pronounced when making decisions than during the planning "should" stage. This is particularly so the busier and more rushed people are in their effort to get things done. Rather than focusing on the immediate and tangible benefits of a given outcome, revisiting those values and principles that you believe should guide your actions may help.

For example, I know an actuary who routinely re-reads the *Code of Professional Conduct* each time she writes a report for a client. A second approach that can provide support to your "should" self when confronted by a possibly unethical choice is the "How Would I Ever Tell Mom?" test.

A third technique is to transform your decision set from a single yes/no option—*"Should I behave unethically or not?"*—to a choice between two explicit options, one that's ethical and another that's unethical.

For example, suppose actual claim rates have been significantly greater than expected rates for an extended period of time. A single option, *"Should I behave unethically or not?"* could be phrased *"Do I ignore this data, yes or no?"* A better dual option approach might be stated as: *"Do I ignore this data, or do I i) commission an experience study, ii) examine the granularity of my model points, and iii) re-read the original pricing memorandum?"* Reformulating the question in this way helps to bring the ethical option to the forefront, and makes it very clear that by selecting the unethical option … one is *not* choosing an explicit ethical option.

After decisions have been made – We're predisposed to reinterpreting our unethical behavior in retrospect so that we (and others) see ourselves as behaving ethically. Setting up decision quality feedback mechanisms can alert one to distorting biases, but the feedback has to be delivered both promptly and candidly, or its effectiveness will be diminished. Implementing systems of governance that hold individuals accountable for their decisions can also help reduce *ex post* rationalization.

Bazerman & Tenbrunsel's prescription to improve ethical decision-making may be summarized as follows:

1. Be aware of cognitive biases—ethical fading, unintended consequences, motivated blindness, slippery slopes and outcome bias—that can lead to unethical decisions for you and others in your organization.

2. Strive to continually counteract these biases before, during, and after making decisions.

More generally, when contemplating important decisions, it may be worth asking both yourself and your colleagues (including non-actuaries), "What ethical implications might arise from this decision?" Then listen very carefully to what your co-workers have to say.

9. REASONABLE CREATURES

The punch line to an old joke suggests that the best way to get to Carnegie Hall is to "practice, practice, practice." In a similar manner, advance preparation can pave the way toward improved ethical decision quality. Using thought experiments and case studies, and becoming more familiar with what actuarial guidance says in principle and means in practical terms, can help when you're confronted by ambiguity and tough decisions on the ethical plane. Contrary to what the adage says, practice does not make one perfect … merely *better*.

The interrelated themes of perception and self-awareness, how actuaries see things and themselves, are central to ethical decision-making. It's been suggested that the honey bees' heightened olfactory sense enables them to "smell in color." Similarly, actuaries (due to our training and experience) are able to see financial risk and probabilities, not in black and white terms, but in living color. Actuaries see things that non-actuaries often do not when it comes to risk, and we tend to see them differently from those that do. This is a great strength of the profession and to our credit. But with strength there often is weakness—in particular, the twin threats of certitude and self-deception.

The risk of certitude is straightforward, and stems from the conviction that actuaries have all the answers—and they're "right" without a doubt!

The risk of self-deception is more subtle, but no less dangerous. Perhaps you've encountered "reasonability tests" frequently used by actuaries to assess

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the robustness of their work. Unfortunately, what's "reasonable" to one actuary is sometimes less than clear-cut. Benjamin Franklin succinctly captured the risk of reasonability tests, and indirectly the threats posed by certitude and self-deception, as follows:

> So convenient a thing it is to be a reasonable creature, since it enables one to find or make a reason for everything one has a mind to do. This is one more reason for actuaries to take some care when assessing outcomes and weighing their decisions.

At the outset of "Ethical Decision-Making for Actuaries – Part 1," I referred to a quote by Edgar Degas, *"One sees as one wishes to see …"* suggesting that one's esthetic taste might serve as an analogue for one's ethical sensibility. They're both very personal and prone to subjective bias, yet how overt or conscious is one's "wish" to see something—esthetically or ethically—a certain way? Without taking anything away from Degas, an epigram from a somewhat unlikely source, Anaïs Nin, may be closer to the mark:

> We don't see things as they are, we see them as we are.

Our professional responsibility to make effective actuarial decisions, while keeping the ethical big picture in view, remains undiminished. Yet losing sight of what's important can easily happen when confronted by challenges on the gray ethical plane. That's why it's necessary to step back from time to time and liaise with other actuaries, to seek out implicit biases and gain perspective—all in order to make better ethical decisions.

EDITOR'S NOTE: CORRECTION – There was a typo in "Ethical Decision-Making for Actuaries – Part 1" published in the August 2012 issue of *The Stepping Stone*, which may have confused readers about the conclusions of the Footbridge Problem. The second to last sentence of the first paragraph on page 20 should read: "Yet, four out of five said they would throw the switch, while only one in six said they would throw the fat man off of the bridge."

[1] Editor's Note: Published in the August 2012 issue of *The Stepping Stone*.

[2] When asked about the first experiment, 23 percent of Knobe's sample said the CEO had intentionally helped the environment, while 82 percent thought that the CEO had intentionally harmed the environment in the second case. Hence, a greater proportion of actuarial session attendees saw the environmental outcome of the first experiment as an unintended consequence than those in Knobe's sample did (i.e. 93 versus 77 percent). And far fewer actuaries apparently saw the environmental damage in the second experiment as intentional or a deliberate act (i.e. 22 versus 82 percent).

[3] The cognitive risks to ethical behavior discussed in this and the following sections draw on their recent and insightful book *Blind Spots: Why We Fail to Do What's Right and What to Do about It* (Princeton University Press, 2011).

[4] Editor's Note: See Ethical Decision-Making for Actuaries – Part 1 in the August 2012 issue of *The Stepping Stone*.