1995 VALUATION ACTUARY
SYMPOSIUM PROCEEDINGS

SESSION 25

Professional Standards and the Appointed Actuary

Robert H. Dreyer

Frank S. Irish

Donald E. Sanning

Lauren M. Bloom*

* Ms. Bloom, not a member of the sponsoring organizations, is General Counsel for the American Academy of Actuaries.

PROFESSIONAL STANDARDS AND THE APPOINTED ACTUARY

MR. ROBERT H. DREYER: I am senior vice president and chief actuary of Erie Family Life Insurance Company. Most of my volunteer time during the last few years has been spent on the activities of the Society's Smaller Insurance Company Section, but I am moderating this panel as a member of the Professional Responsibility Committee of the American Academy of Actuaries. I am going to introduce each panelist immediately before they speak.

Our first speaker is Frank Irish. Mr. Irish was corporate actuary and appointed actuary for the John Hancock Mutual Life Insurance Company from 1987 until his retirement in 1994. Prior to that he had been head of the retail actuarial department and the corporate planning department. In 1994 he became a member of the Actuarial Standards Board of the American Academy of Actuaries. His presentation will relate to his role with the board and the board's role with respect to the profession.

MR. FRANK S. IRISH: We all know that appointed actuaries are well-trained and proficient in the exercise of their science. I think you should be quite rightly confident in your ability to model cash flows under various scenarios and to judge the soundness of reserves. And yet, despite that basic confidence, I suspect that all appointed actuaries have a nagging concern that something unexpected, from somewhere in this complex world, is going to emerge that will make them look bad. It's hard for appointed actuaries to keep up with everything they need to know, which ranges all the way from investment risks to regulations. In talking to you about the Actuarial Standards of Practice, it is my feeling that you may view these standards as one more trap for the unwary actuary. It's not easy to keep up with them, or to sift out from them what is relevant to the daily work of appointed actuaries. That is why the Actuarial Standards Board has a current project to cross-index all the standards according to their relevance to various actuarial responsibilities.

Once that project is completed in the next few months, it will be a little easier for actuaries to have a simple list of which standards apply to their particular functions. It is in that spirit that I am

speaking to you at this session. I would like to talk about some of the items in the standards that may bear on your work as appointed actuary in unexpected ways.

Of course, you are all familiar with *Actuarial Standard of Practice (ASOP)* 7 ("Performing Cash-Flow Testing for Insurers"), *ASOP 14* ("When to Do Cash-Flow Testing"), and *ASOP 22* ("Statutory Statements of Opinion Based on Adequacy Analysis"). These are the mainstream of standards for appointed actuaries. Perhaps I should also include Actuarial Compliance Guideline Number 4, which governs reserve standards in smaller companies.

The pertinence of these four standards to your work is obvious. And in the interest of time I'm not going to focus on them. What are some of the other standards that might have unforeseen applicability to the task of the appointed actuary?

I'd like to suggest a few possibilities here. For example, there is *Actuarial Standard of Practice 5* ("Incurred Health Claim Liabilities"). In larger companies, appointed actuaries are not generally involved directly in establishing and testing claim reserves, but they do have to review this work and satisfy themselves as to its soundness and its compliance with *ASOP 5*. There are certain points in this standard that represent likely pitfalls, and these are the points that appointed actuaries should be looking out for.

Incurral date is one such point. The contractual provisions and claim practices determine the date when a claim becomes a liability. Unfortunately, the claim and accounting systems do not always provide an accurate record of that date, and actuaries have to be careful.

Claim settlement expenses have to be recognized in the liabilities. In analyzing claim lags, actuaries also have to be alert for possible changes in claim procedures that could make past lag patterns inappropriate for today's liability.

Finally, actuaries have to be sure that follow-up studies are done. That is, the claim liabilities of prior years should be tested against the actual run-off to see how accurate they really were. Actuaries

should not only perform such studies, but should also be sure to utilize the results in making current estimates of claim liabilities.

Let me turn next to *ASOP 11* ("The Treatment of Reinsurance Transactions in Life and Health Insurance Company Financial Statements"). This directs actuaries to make sure that all of the possible effects in cash flows have been considered, including such tricky items as allowances, experience refunds, risk fees, contingent payments, etc. The likelihood of collection must be considered, if there is the slightest doubt about the security of the other party to the transaction.

Assets and liabilities appearing elsewhere in the statement as a result of receivables and payables have to be taken into account in determining reserves on reinsured business. Also, possible future obligations to reinsurers should be recognized.

Another standard of significance for us is *ASOP 21* ("The Actuary's Responsibility to the Auditor"). In this we can see that the appointed actuary has to be ready to provide the auditor with whatever detail is necessary about the data, assumptions, and methods that we use in preparing and testing the reserves, and be ready to appraise the suitability of the methods used. Documentation requirements are included, also. The need for documentation can vary enormously. Although it can frequently be fulfilled by material usually prepared for asset adequacy analysis under *ASOP 22*, there are occasions when dealing with the auditor will require additional documentation.

Actuarial Standard of Practice 23 ("Data Quality") discusses how actuaries should, among other things, check data for reasonableness and consistency; it goes deeper into the provenance of any data that may appear questionable.

ASOP 23, as well as *ASOP 22* and Compliance Guideline Number 4, contain some wording on the disclosure of reliance. The actual wording of the disclosure, as well as the need for formal letters of reliance, is currently more a matter for regulation than for standards. I don't need to dwell on this with this audience, because I think all of you are well aware of the need for very detailed disclosure of reliance, including copies of letters from those that were relied upon.

There are three other standards of less direct relevance to most of you, but still worth mentioning. *ASOP 6* ("Actuarial Present Values of Retiree Health Care and Death Benefits") may have an impact on statement preparation, and *ASOP 10* on "GAAP for Stock Life Insurance Companies" could effect your work. Finally, there is *ASOP 18* ("Long-Term Care Insurance"); it's unusual for a standard in that it covers all actuarial aspects of a single coverage. There are some unique features of that coverage that should interest appointed actuaries who have to review reserves for it.

For example, there is the admonition that lapse assumptions should be kept low. In most coverages, high lapse assumptions are the conservative course, but this one is different. That standard also warns against the inappropriate use of development methods for claim reserves and emphasizes the importance of recognizing inflation in claim and expense assumptions.

That covers most of the standards I wanted to mention, but there are, in addition, the *Financial Reporting Recommendations (FRR)* of the Academy. Often neglected, and admittedly, often superseded by incorporation in standards of practice, these are nonetheless worth a look. From your point of view, I would particularly mention *FRR 7*, "Statement of Actuarial Opinion," *FRR 9*, "Materiality," and *FRR 11*, "Interest Indexed Universal Life."

Finally in my list, I want to recommend for your attention the booklets entitled *Code of Professional Conduct* and *Qualification Standards for Public Statements of Actuarial Opinion*. In particular, you should recognize that actuaries, according to the code must: (1) ensure that subordinates follow the standards; (2) take responsibility for their work product (except where reliance is clearly stated); and (3) be sure that they are qualified for the function that they perform.

In a sense, the Qualification Standards serve the purpose of filling in the details on this last point of making sure that you are qualified for the function that you perform. They are very specific for those signing annual statements. Among the qualification requirements for statement signers are: actuarial examinations on specific topics; three years of relevant experience; and 12 hours per year of continuing education.

With regard to continuing education, I specifically recommend that you keep in your file a simple record of your continuing education activity, with location and subjects, and with a total number of hours shown for each calendar year. You can, I presume, include this session in your total.

I've mentioned 11 different standards of practice, as well as three other Academy booklets. This represents a great deal for practicing actuaries to keep abreast of, given all the other things they have to do and keep in mind in the course of daily work.

It's rather overwhelming to think how easy an accidental transgression might be, and yet my purpose in reminding you of this is not to try to intimidate you. Think rather of this review of the standards as part of the process of helping you to do your work, and maintaining awareness of the consensus view of what is right, because I do believe that virtually all actuaries want to do the right thing.

It is not necessary to set up a massive and coercive machinery of enforcement in order to bring about proper behavior. The instances of misdeed, where disciplinary or legal action is involved, are relatively rare, although I suppose we all must keep in mind the possibility that some day one of those rare actions may be aimed at us. However, I think we would all agree that the main purpose of the standards is to provide support for the natural desire to do the right thing.

Pressures do come from all around us to cut corners. With the current pressures for higher surplus ratios, management is eager to keep reserves as low as possible. There may even be some managements that don't want to hear about adverse scenarios. Above and beyond the pressures on results, there are the pressures on process, because compliance with actuarial standards is becoming increasingly more demanding of actuarial time and resources. Actuaries have to defend the amount of effort that goes into testing and verification, and, above all, the effort that goes into documentation and disclosure.

With the best will in the world, it is hard for actuaries to stand up and say, "This is the right way to do it," unless they have something to point to that supports that contention. Keep this in mind when you observe the sometimes tortuous, confusing, and time-consuming system of standards adoption.

The intent is to have it represent a consensus about good practice, not the opinion of a few experts about how and why things are done, as often is the case with educational material. It is not even the most technically advanced approach to actuarial work, such as one might see in professional journals; it is more the general opinion in the profession about what is right.

It must also be remembered that the Actuarial Standards of Practice are not simply instructions on how to do actuarial work. As a matter of fact, the standards leave a great deal of room for the exercise of judgement. How specific to be in any particular case is always a difficult question for the Standards Board. It is my own feeling that many of the standards are not specific enough. For example, I would have favored something more in *ASOP 22* about how many scenarios can be failed before one must adjudge reserves to be inadequate. Some indication of the probability level that is encompassed in the phrase, "moderately adverse conditions" also would have been helpful.

That's the position I take, because I believe that actuaries need that kind of support to do their job. Others believe that the standard should not be too directive. In the end, it is a matter of finding the right balance.

To some extent, of course, the gap is filled by practice notes, which are often very specific. But practice notes carry a lesser weight of authority, somewhat more, perhaps, than study notes, but definitely less than standards of practice.

In any case, appointed actuaries want to do the right thing, but it isn't always easy to know whether a particular action is right, or to explain why it is right. The standards of the American Academy of Actuaries are there, I hope, to help you with this.

MR. DREYER: Our second speaker is Donald Sanning. Mr Sanning is second vice president and actuary of The Principal Financial Group and is the appointed actuary for Principal Mutual Life. He is a member of the Academy Committee on Life Insurance Financial Reporting and the Committee on Professional Responsibility, and he is the chair of the Academy Task Force on the Professionalism Course. At last year's Valuation Actuary Symposium, I reported on a survey the Committee on

Professional Responsibility made of valuation actuaries. In that survey, a number of actuaries were kind enough to send us blind copies of their opinion letter. Don has analyzed those over the last year and is going to talk about them tonight. What are they saying Don?

MR. DONALD E. SANNING: I found out that they say many different things. It was rather interesting to go through these opinions. Some of them were very short and to the point -- covering just what was recommended in the actuarial opinion and memorandum regulation. Other actuaries went beyond the minimum requirement and included other statements they thought appropriate for their situation.

I'm going to go through some of the things that I found. I don't intend to talk about the boiler-plate language, but I will highlight some things that were more interesting. I'm going to skip over some things that are in Appendix A, which is included at the end of this session chapter for your reference.

There were 46 of these opinions; these were 1992 opinions, so they're a year old, but I doubt that they've changed all that much. This was not a scientific survey. It just covered opinion letters from those who were willing to contribute, and we were appreciative of those that did.

Let's consider for a moment, the provisions that are *recommended* by the actuarial opinion and memorandum regulation, and I highlight the word recommended. These provisions are recommended, but they are not required to be in the language specified. They can and should be changed to fit your circumstances. And because everybody's circumstance is different, the boiler plate language isn't going to fit everybody's situation. One thing you might do is check the recommended language in your opinion to see if it meets your situation.

There are some omissions from the recommended language in the surveyed opinions. I'm not sure just how appropriate they are or what the circumstances were.

The first thing I want to deal with in detail is notification of appointment. This has been a topic of conversation in actuarial groups at various meetings. For example, how are you going to do this.

Are you going to send in letters of notification to different commissioners at different times? If so, do you have to file different opinions? Can you use one opinion? How do you deal it?

There were three ways of dealing with this problem. One actuary gave the date of appointment, not the date of notification to the commissioner. Another actuary attached to the opinion a list of states with the dates of each notification; I believe there was actually an appendix by state for all 50 states, and the date the notification was sent to each commissioner. Another actuary notified states as the law became effective for that state.

Reliance is another area of interest. Below is a list of items relied on. The wording is directly from the opinion so you have to guess what they were talking about.

- Cash-flow
- Cash-flow variance
- Asset assumptions
- Investment information
- Call and prepayment provisions
- Default risk
- Investment policies
- Investment strategy
- Interest crediting

One actuary made the statement that he or she had discussed the asset cash-flow assumption; he or she did not verify it, but did review it for reasonableness. This approach was different from what most actuaries had said.

There is one area where I think you need to be a little careful: subparagraphs B(4) and B(5) of Section 8. B(4) relates to a situation where the actuary has examined the underlying asset and liability records. Subparagraph B(5) relates to where an actuary has not examined the underlying records. I found a couple of opinions that had both of these statements, and they weren't mutually exclusive. They said for both assets and liabilities I did and didn't rely on others.

Section B(6) has recommended provisions for the actual opinion. If you will recall there are the five statements: a, b, c, d, and e. Most actuaries followed the recommended wording. There were a couple of interesting variations on Item C which is on state compliance. There has been quite a bit of discussion at this meeting about this provision. One actuary strengthened his or her opinion by saying the reserves met the requirements of the state of filing. This is a little different from the recommended provision which calls for meeting the requirements of the state of filing in the aggregate.

At the other end of the spectrum there were several that said nothing at all about the adequacy of reserves for the state of filing. And then there were a couple that expanded their opinion by referring to the administrative rulings of the state.

There is a paragraph that deals with a call for a statement that there have been no material changes from the date of statement to the date of the opinion. A couple of actuaries based this on a reliance statement. Rather than just make the statement that there hadn't been any, they made the statement based on reliance from some other officer of the company. Others referred to changes that were effective on January 1 of the following year, mostly changes in reinsurance agreements that were going to start or stop on January 1 of the following year.

One of the last provisions is a statement about whether future experience may not follow the assumptions. Remember, when this regulation first came out, there was some discussion about whether to use *may* or *will*. Most people were using *may* but there were a lot of people who were using the word *will*, if that's of any interest to you.

The following is a list of the asset adequacy methods that I found. The terminology is right out of the opinion. Some of the methods are rather interesting, or at least the terminology is interesting. Some included a brief description of the method and this might be helpful if you have a method that's a little different or if some of the terminology isn't quite clear.

- Cash flow
- Cash flow using claim run-off studies

- Cash-surrender scenarios
- Gross premium
- Conservative assumptions
- Development method
- Loss-ratio method
- Short-term nature of liabilities (e.g., health)
- Risk assessment
- Introspective obligation risk analysis
- Actuarial analysis method
- Margin analysis
- Comparison to tabular funds
- Illiquid nature of liabilities
- Policyholder bears all risk (e.g., separate account)
- Not applicable, not tested, immaterial

Now I want to spend some time on what actuaries have added. Most of what I've talked about before follows the recommended provision. But it's equally interesting to see what actuaries have added to their opinions.

One deals with the scope. Who is the intended audience? Many actuaries listed the audience as insurance departments and regulators only; others included management. Some included a disclaimer for use other than intended. In other words, they were trying to limit who this opinion applied to.

Other statements included were: The opinion should be reviewed as a whole, and you're not supposed to take pieces out of context. The opinion is a product of professional expertise. In order to really understand the opinion, you should get some professional help in interpreting it.

There were quite a few who mentioned the memorandum in the opinion. I'd raise a flag here and say be careful about this. Such a reference may make the confidentiality of your memorandum no longer appropriate. This is discussed in a memorandum dated November 30 from the California Department

entitled, Actuarial Opinions and Memoranda from John Montgomery. In that memorandum he says, "On one point we are holding firm. Some actuaries state that the opinion may not be read without also reading the accompanying memorandum. This renders the actuarial memorandum no longer a confidential document. This is certainly not the intent of the actuary. The law's intent is to protect the confidentially of the memorandum." So you may want to talk to your attorney about it if you're referring to the memorandum in your opinion. There are also a couple of places where the comment was made that the opinion is made to comply with the requirements of the valuation law.

Then there is a set of statements that dealt with the relationship of the basis of the opinion. For instance, they talk about what lines were aggregated and what the basis was for aggregation, and whether it was before or after testing. There were statements that the opinion does not deal with solvency; that the testing date was other than December 31; which reserves were modeled or tested and which weren't; was reinsurance considered or not?

And then there were people who obviously filed in New York, because there were some statements that had been required by the prior versions of the New York Regulation 126. The actuary was to consider provisions of asset characteristics, contract provisions, investment policy, interest crediting philosophy, and the fact that expenses are on an ongoing basis.

There were a couple of other miscellaneous topics. The recommended language talks about whether there were any material changes from the date of statement. There were several who said nothing from the date of testing which would probably have been prior to the date of the statement.

There are a few other statements that either are used or not used that dealt with the asset valuation reserve (AVR) or interest maintenance reserve (IMR). This is not a prediction of future experience.

These are some of the things to consider in putting this opinion together. Remember this is your opinion; it should say what you want it to say, what you need it to say, and what's appropriate for your circumstances. The recommended language is there as a guide for you but not as something that absolutely has to be said. It should say what you want it to say.

Frank has already talked about some of the applicable standards that need to go into your work. And in some cases what needs to be said in your opinion. Let me just highlight a couple that really relate to what is said. This is not necessarily a complete list of everything that you need to do, but there are some provisions in these standards that say something about what needs to be said in your opinion.

For instance, there's *ASOP 7*, "Performing Cash-Flow Studies." Most of this is really documentation that would be in your memorandum. *ASOP 11*, which deals with reinsurance, has a provision that the opinion should have a statement on how you dealt with reinsurance. Did you deal with it or not? How did you do it? *ASOP 14*, "When to do Cash-Flow Testing" says the opinion should have a statement as to whether cash-flow testing was done, and if not, why not? And while it's probably not technically required, it would be informative to include a short description of what was or what wasn't tested.

ASOP 22 which relates to the opinion based on asset adequacy methods, calls for providing an opinion to management. I referred to this earlier. If your opinion says that it is for insurance departments and regulators only, that implies that you have something else that's going to management. This may be the case, but you may want to reconsider that language.

ASOP 23 on data quality calls for disclosure on the extent of reliance. This is a big point with the regulators as to how much and on whom you're relying. The statement should probably also include the extent of the reliance and the extent of the review that you made. In this conjunction, it ties together with *ASOP 22*, which requires a statement about the information relied on as being reasonable.

Another practice note is the legal practice note. This is a good one to review and talk about with your attorney. What do you want to put in your statement, including possible ways of limiting your liability? The note suggests some things to consider: the purpose of the opinion; whom it is intended for, and a disclaimer for use other than intended. The opinion should be viewed as a whole, to avoid taking things out of context. Consider that it's a product of professional expertise and use

professionals to review it. You remember these from some of the earlier discussion. Evidently, some people have read this practice note.

I was going to deal at this point with some proposed changes to the actuarial opinion and memorandum regulation. But Larry Gorski, in a presentation just prior to this, did that much more authoritatively than I can.

A revised version of the regulation should be out in late fall of 1995. I suggest you get a copy of it, review it, and comment on it. The fact is that people did comment on it and those comments were taken into account and some changes are being made based on those comments. I encourage you to comment on it because this regulation affects you and your job and what you're saying in your opinion. You ought to be interested in it and you ought to comment on it.

MR. DREYER: The last of this blue ribbon panel is Ms. Lauren Bloom, General Counsel of the American Academy of Actuaries. This is a position she has held for almost four years. She graduated from Yale in 1979 with a B.A. in English. She received her J.D. from the Columbus School of Law at Catholic University of America in 1985, where she was valedictorian of her law school class.

She also holds an advanced degree in labor law, with distinction, from Georgetown University Law School. Ms. Bloom began her legal career as a trial attorney with the civil division of the U.S. Department of Justice under the attorney general's honors program. She then spent four years in private practice before coming to the American Academy of Actuaries, and believe me, this has been our gain. Ms. Bloom's litigation experience focused on both the application of standards and due process within the context of accreditation systems and on employment discrimination issues.

As general counsel of the Academy, Ms. Bloom also provides legal advice to the Actuarial Standards Board and the Actuarial Board for Counseling and Discipline. Frank has told us what we should be thinking about doing, Don has talked about what some of us are doing, and now I'm going to ask Lauren to tell us how to stay out of trouble.

MS. LAUREN M. BLOOM: Well, of course the safest way to stay out of trouble is never to get out of bed in the morning, because in fact, trouble is to some extent something that goes with being human. You can get in trouble by crossing the street, but there are some things that you as valuation actuaries can do that will really help you in your practice and will reduce the risk of being in court being grilled by somebody like me.

If there were no valuation actuary laws to begin with, if there were no standard valuation law, it is not true that you, as actuaries, would have no liability. Where there is no statute, the liability comes out of the common law of the United States, that is, in turn, derived from the common law of England.

Under common law, everybody has certain obligations. The first is an obligation to avoid intentional misconduct: things like fraud, theft, murder. So the actuary who embezzles $20 million from an insurance company and high tails it off to the islands, is not guilty of malpractice. This person is guilty of an intentional tort.

There's also an obligation to avoid what the law refers to as gross negligence. The example that's usually used in law school is somebody who chugs down half a bottle of scotch in ten minutes, and then drives a car at 80 miles an hour through a crowded kindergarten playground. That is, in short, carelessness that is so unbelievably irresponsible that it might as well be intentional. That is gross negligence, and it is not something that I find actuaries tend to do.

Actuaries tend to be very honest people. They tend to be very straightforward people. They tend to be very careful people. An actuary typically isn't going to trip up on intentional crimes like fraud or theft, or gross negligence; rather, an actuary might be accused of garden-variety negligence which, in the hands of a professional, is called malpractice.

Under common law, only a professional can be sued for malpractice. Nonprofessionals can't be the object of malpractice suits; so if you are ever sued for malpractice, try to take it as a compliment. Nevertheless, malpractice is professional negligence, and there are several elements that come into

it. This is important because it's going to come up again when we talk about the valuation actuary law.

First, you owe a legal duty to the plaintiff. Now you always have a legal duty to people with whom you have voluntarily entered into a professional relationship. So if you're in-house, you have a legal duty to your employer; if you're a consultant, you have a legal duty to your client. But there may be third parties to whom you also owe a duty -- someone with whom you have no direct relationship. These are people who, one way or another, get their hands on your work product, rely on it and get injured.

Now that injury is important because of your legal duty. The next question is, what is that duty? Legally, your duty is to act with the same care that a reasonably prudent actuary would under the circumstances as you conduct your practice in accordance with generally accepted actuarial principles. Keep that phrase in mind; we'll come back to it.

The third element is that you must have breached the duty, not of acting in accordance with generally accepted principles, or as a reasonably prudent actuary would. In short, you don't have to be perfect, but the law requires you to have done what a reasonably prudent actuary would have done under the circumstances.

Fourth, your breach has to have caused the harm. If the harm comes from some other source, or if there has been contributory negligence, or someone else has been involved, as is often the case when actuaries work, you may not be responsible. For example, you can recommend reserve levels, but if management says, "Thank you very much, that's fine, go back to your office, we have things to do here," at that point you're not responsible if they make a mistake. So their negligence essentially contributes to the problem, and therefore you didn't cause the harm.

Finally, there needs to be what the law calls "proximate cause," that is to say, direct causation of a sort that the law will recognize. If you get to the point of proximate cause, call an attorney.

Under the common law, you have varying levels of liability, for example, to the third party. There may be people to whom you don't owe a duty under the common law, but you can owe a duty if a statute says you do. Under the common law you also, at least in some states, can limit your liability to third parties by using the kinds of disclosure language that Don was talking about.

So if your opinion says, "Not for use by anyone but the insurance company and the regulators," and a third party like a bank or a policyholder relies on your opinion, under some state laws, it is not reasonable for that person to have relied on your work. So language like that can be very helpful.

However, everything changes when statutes come into existence. And, of course, the standard valuation law is a statute, and it does change your liability. Under the NAIC model standard valuation law, the appointed actuary who signs the opinion is personally liable for fraud -- that's absconding with money, gross negligence, or garden-variety malpractice. But the model limits your liability for garden-variety, malpractice-style negligence to the insurance company and the insurance department.

So other third parties cannot look at your opinion, rely upon it, to their detriment and sue you for negligence. That's great news if you have a state that has adopted the NAIC model. But as I'm sure you all know, some of the states have tinkered with the model in varying ways. And California, at least, changed the liability provision of the NAIC model when it adopted it.

The Academy sent me to California, and we got the law amended. I believe that the amended law, taken in combination with case law, gets us back to where we would have been with the NAIC model, but I won't know for sure until somebody is sued in California. Unfortunately, we can only hope that what we have is going to be sufficient.

I spend a fair amount of time on the road going to various places and talking to the state legislatures to make sure that the limited liability provision stays in the law. For example, it is now in South Dakota and would not have been unless the Academy became concerned and dealt with it. This is important, because if you are personally liable, and there's nothing in the statutes that limits your

liability, anybody who gets a hold of this statutorily required opinion and relies on it to their detriment is a possible plaintiff against you.

I should indicate, by the way, that some regulators have indicated a certain hostility to the sort of language that Don described earlier, but it's the kind of disclosure and disclaimer language that I think is quite appropriate to keep people from misusing your work product. Nevertheless, there are some state regulators who don't like it. California had proposed a regulation that would have barred it. I think that particular proposal would not have passed legal muster.

Think for a moment about the magnitude of that personal responsibility. It is enormous. Even the smallest insurance company is dealing with an awful lot of money. Now this doesn't mean that you don't render the opinion. It just means that you render the opinion understanding what your risks are and that you have to be very careful to at least meet the generally accepted actuarial practices as you prepare and file your annual statement opinion.

Also its very important to recognize that this level of responsibility is there. You must respect it, because, as Frank pointed out, reliance is critical when you issue an opinion. I cannot imagine the company that is so small and so narrow that you personally can check out every aspect of every bit of information that you could ever conceivably need to create that annual statement opinion.

You must rely on other people. You probably have other actuaries working with you who are doing much of the underlying work, maybe even writing parts of your opinion, and certainly parts of the memorandum. You are going to have to look to those folks to give you what you need, to issue the opinion on which you are hanging your personal liability and your personal reputation.

Now I want to say a word to you about reliance. As Frank said, reliance is something that the standards recognize is going to happen and something that the Code of Professional Conduct recognizes is going to happen as well, because no one person can do it all. The problem with that, is that reliance is probably not going to be an adequate shield for you if the data or other information that you rely on is manifestly wrong. You are not lay people. As the appointed actuary you are

wearing the hat that says, I am an expert. I can see things and recognize problems and spot inconsistencies that an ordinary person walking down the street couldn't see.

So if you are handed data that don't make sense to you, or if somebody brings you a piece of actuarial work that doesn't seem to be logical when you look at the way the runs came out, what is your duty? I think you will find it is not an effective defense to say, "Oh well, I relied." If something bothers you, check it out, particularly if something came out of your computer.

I recognize that we all live in an age where we have these wonderful little boxes. You punch a button or a series of buttons and out comes the string of information, and if the computer issues it, it must be correct. Right? Wrong! A computer is a machine; machines make mistakes. Machines do not have judgement. So if the number that comes out of your computer, or the string of numbers or what have you, doesn't make logical sense to you, the odds are pretty good that you're right and the machine is wrong. Don't let it go by; you have too much at stake.

So having said all of this, what can you do to protect yourselves as you go forward in this very responsible position that you take on as the appointed actuary? First of all, don't agree to serve as the appointed actuary unless you are certain that the assignment isn't going to expose you, or your firm, if you're a consultant, to an unreasonably high risk of suit.

Every circumstance is different and only you can really determine what's going to make you, as a professional, comfortable. There are a few things that you want to look for because they're high points, and if you see one of them, slow down. It isn't that you shouldn't take the assignment -- just slow down and think about it before you do.

One example is last minute requests, for example, people who come to you a week before the opinion is due and ask you to get something done. Perhaps the urgency seems to you to be irrational. Suddenly they're in an all-fired hurry to get this opinion that they could have asked you for three, four, or five months ago. Stop, slow down, and if you're not going to have time to do it right, think very carefully before you agree to do it at all.

Another thing to look for is conspicuously absent data. Has anyone ever seen perfect data? Barry Watson swears he has. He's the only person I've ever met who does, but when I questioned him about it, I found out it was a one-participant pension plan.

There's no such thing as perfect data. We understand that, and the data quality standard recognizes that. You're not required to be auditors of data, but if a critical piece is missing, or if the numbers don't add up no matter how many ways you try them, or if the data shows signs of having been tampered with, ask a lot of questions. Get it cleared up before you agree to do the opinion.

Misrepresentations from company management. If you catch people in a lie once, be very careful not to let them lie to you again. We all know that people don't ever intentionally lie. Right? Nevertheless, management has its goals, they have their plans, they have their wonderful ideas. Of course, if we can just get rid of this little glitch, everything is going to be golden, so we'll fudge a little with the actuaries. If you find that people aren't being straight with you, ask many tough questions until you're satisfied that you know what you need to know.

If you find that the staff that's supposed to be working with you are evasive or uncooperative or never at their desks or don't return your calls, follow up and insist on getting the information you need. Also, if the company refuses to permit you to contact the prior appointed actuary, assuming there was one, that may also be cause for concern.

You aren't required to contact the prior actuary, although the Code of Professional Conduct says that it's probably a good and prudent idea. You may not want to, and you may not feel that you have to, but if you ask for permission and you're told no, find out why and make sure you believe the answer that you're given.

Assuming that you do agree to serve as the appointed actuary, please make very sure that you, and everybody working with you, is in compliance with all of the professional standards that apply.

Remember when I said that your obligation is to perform in accordance with generally accepted practice? If I, as an attorney, have to go in front of the judge to claim that you, the actuary, have failed to meet generally accepted actuarial practice, the first thing the court is going to say to me (because they don't know actuaries anywhere near as well as you know each other) is, so what is generally accepted actuarial practice? It's not so very different than what you have seen in the O.J. Simpson trial over the last several months.

There are several ways that you can do this. You can bring in experts for either side, for the battle of dueling experts. Sometimes one is more convincing than the other, or maybe the judge won't like either one. Or perhaps you appoint a special master or whatever. Or you can bring in many published papers, articles and so forth, and you can try to argue that the published material reflects what's generally accepted in the profession.

If I'm the attorney, I can whip out the standards binder, pull out the little gray booklet, and say: "Your Honor, this standard was adopted by a nationally recognized board of experts. The standards that they promulgate are incorporated by reference into the Codes of Professional Conduct of all five of the U.S. organizations that represent actuaries. All of their members are required by the code to follow these standards whenever they provide professional services in the United States." "I submit to you, Your Honor, that the Actuarial Standards of Practice are generally accepted practice in the United States." I would say that probably halfway through that statement the judge is going to start nodding, because it makes good sense. So what that means is that when you practice, you must be in compliance with the standards of practice or you're going to have a real uphill fight to argue that what you're doing is generally accepted.

It doesn't mean that you can't build a better mouse trap. It doesn't mean that you can't decide to do something different. In fact the standards themselves recognize that that could happen. Before the session, for instance, one of our members came up to me and said, "You know, I have a situation where I really don't want to do Section 8 cash-flow testing. It's on an annuity program that needs about $600,000 of reserves, but it's run by a small nonprofit corporation that has had about $52 million in assets and gets about $4 million each year in interest income." Now that's a program that's

not in any trouble. He doesn't want to run up the money to do cash-flow testing. Under circumstances like that, it might be an appropriate professional judgement not to do cash-flow testing, whatever statutory requirements there are. Aside from the purposes of the standards of practice, under those circumstances, it might be appropriate not to.

Then you'd want to look at the deviation clause at the back of each standard, because if you depart from the standards, you can do that. You need to put in your work product an appropriate disclosure of the fact that you've departed, the way that you've departed, and how that departure changes your work product.

You can definitely build a better mouse trap or do something differently, but if you do it, make sure you disclose it. If you don't, you're going to be out of compliance with the standards. If you try to do something that's seriously different from the approach that's taken in the standards, make sure you're not doing something that's off the wall.

As Frank said, the standards are not cookbooks; they allow much room for actuarial judgement. By the same token, however, they also have not been put together in a vacuum. They're put together by people who are your peers, who are experienced professional actuaries who have given things a great deal of thought. The lists of factors that they ask you to consider as you perform particular tasks are not ill advised. They make sense.

So use the standards. Even if you depart from them, the fact that you thought about these things is likely to increase the quality of your work product.

You also need to do several other things under the Code of Professional Conduct. The Code of Professional Conduct, having been adopted by all five of the U.S. organizations, is probably also compelling evidence of what constitutes generally accepted ethical practices in the United States. So you need to know what your obligations are under the code. When you go back to your offices, blow the dust off your yearbooks and look at the Code of Professional Conduct.

There is one code for all five U.S. organizations at this point. It took us a couple of years to get there, but we have one code right down to the commas, so if you've read one, you've read them all. You need to be aware of the fact that you are required to follow that code whenever you provide professional actuarial services, and that includes issuing opinions under the standard valuation law (SVL).

The code addresses a variety of ethical issues, and some are going to be more relevant than others to you, depending on what you're doing and what your circumstances are. Some that are always going to come up are: Precept 1, which requires you to act honestly and in a manner to uphold the reputation of the profession; Precept 2, which requires you to perform services with integrity, skill and care; Precept 3, which requires you and the people working under your supervision to be qualified to do the work that you do and to follow the Qualification Standards. I'll come back to that.

Precept 4 requires you to follow the standards of practice of the Actuarial Standards Board. Precept 7 says that you shouldn't allow your work to be used to violate or evade the law. Precept 11 requires you to perform professional services with courtesy and discusses the fact that it's often prudent to contact the prior actuary, if any.

Now back to the Qualification Standards. I probably get more questions about those standards than I do about anything else. If I don't get one call a week there's something wrong. The Committee on Qualifications of the Academy, which promulgates the Qualification Standards, has recognized that they are probably not as user-friendly as they need to be, so it is in the process of writing an easier, clearer draft.

You need to be aware that, as appointed actuaries, you have to meet the specific qualification standard for issuing life statement opinions. That is in the back of the volume, and it includes: passing the appropriate exams, three years of recent relevant experience, and 12 hours a year (averaged over a two-year period) of continuing education, at least half of which needs to be what we call "organized" activities. The other ones are called "other activities," not "disorganized" activities. This panel is an organized activity, and yes, Frank, it counts.

If you have questions about the Qualification Standards, you can get confidential guidance from the Committee on Qualifications of the Academy. Write to them at the Academy office. We will get you an answer, and we promise we won't copy anyone you know. If you're not sure, double check. And if you need to get your continuing education up to speed, or there's an exam you haven't passed, do something about it.

Now for the practice notes. The practice notes, unlike the standards of practice, do not bind upon you under the code. They are advisory. In fact, we work very hard to make sure they're advisory, because we really don't want them to be used in court as evidence of generally accepted practice, the way that the standards of practice are likely to be.

However, it is still possible that the practice notes may some day find their way into court, and depending on the circumstances, the skills of the two attorneys, the mood of the judge that day, and the relevance to the case, they might come into the record of a trial. So it's probably not a bad idea to read them. If you don't have them, or if you're missing any of the standards of practice or the Qualification Standards or the Code of Professional Conduct, call the Academy office. We will not turn you in to the ABCD. We will just send you copies of whatever standards you're missing. And if you don't have the standards at all, you can buy the entire set for about $60.

If you are an Academy member, you get them as a service to the Academy membership. Otherwise, please get what you need, because you can't do the work without them. It's not enough just to follow the standards; you need to document your compliance, because in litigation, what matters is not so much what you did as what you can prove that you did. If you can document your compliance and keep that documentation in your work files, you'll be better positioned if your work is being challenged several years down the road.

Lawsuits don't get filed quickly. They get filed, for example, after a company goes insolvent or if a pension plan fails. Usually that is several years after the critical mistake was made. So if you have documentation in your files to demonstrate what the standards were at the time you rendered your opinion, and what you did to follow them, that's a nice thing to have, because then you do not have

to remember, years after the fact, exactly what you did. You may find yourself arguing with the other side about whether what you did was appropriate, but at least you're not paying an attorney $200 an hour to try to figure out what happened.

What you also need to remember, however, is that your files are subject to discovery right now. In the United States, under the Rules of Civil Procedure, your files are subject to discovery, whether or not you or your company are parties to litigation. The discovery rules are extremely broad. They allow access to anything that could reasonably lead to the discovery of admissible evidence. That is more or less the known universe.

There are games lawyers can and do play. For example, sometimes an attorney will say, "See that warehouse. All the papers you could ever want are in there. Here is the key, good luck." Nevertheless, you should operate on the premise that the things that are in your files could end up under the nose of the judge someday, and you should maintain your files accordingly.

What that means is you want to keep permanent copies of any document that's in final form, whether that's your annual statement opinion or correspondence or memoranda or what have you. You generally want to get rid of drafts of documents after they come into final form, and you really want to avoid little notes in the margins of documents. They are only cute at the time you write them. They are never cute at the time you have to give them to opposing counsel. So please, if you have to do them, do them on sticky notes, and throw them away. Don't leave notes in your files.

You also don't want to leave notes on any unresolved questions. Ideally, by the time your statement and opinion are completed, there shouldn't be any significant outstanding questions, because you should have run them all down. It is good to keep a list in your work file of things that still have to be run down and check them off as you go, so you know what you've done. If for some reason, you haven't run something down, you either need to make an affirmative determination that it isn't relevant and scratch it off your list, or you need to run it down. Don't leave unanswered questions in your file; they are deadly.

You also need to be particularly careful about *Actuarial Standard of Practice 23*, which is the "Data Quality Standard." That standard, as I said, doesn't require you to audit data, but it does require you to look at your data for reasonableness and consistency. Then make appropriate disclosures in your work product if the data isn't perfect (and we all know it isn't going to be).

So you need to know what your obligations are under that standard, and you need to follow the standard. It is particularly important because, as an attorney who makes his living in this field told me, there has yet to be a malpractice action filed against an actuary in this country that didn't involve a data quality problem. So follow the standard.

Now what else do you need to do? Make sure that you maintain good communications with company management. That's how you get those outstanding questions answered. You have to get the information and the support that you need to do a quality job. If someone isn't getting it to you, you need to get around them, or over them, or get them to do it. That means to get the data that you need you may need to be friendly and polite but firm with a variety of people.

You also want to ensure that you work with your company attorney, so that the work that you do is in compliance with the laws and regulations of each of the states where it's going to be filed. That's a massive job; that's what lawyers are there for, so use them. Attorneys are also particularly good at crafting the kind of disclaimer language that Don was talking about, so take advantage of their help. You also want to be sure, when you look at your opinion and before you hand it over, that it not only says all the things that you want it to say, but that all of the things that it says are true -- not close to true, not bordering on true, not true as long as you ignore several key factors, but simply true. Take your time. If the opinion is a little longer this year, that's okay, but make sure it's accurate.

Something you may want to look into, depending on your circumstances, is getting an indemnification agreement from your client or employer. This is something that many consulting firms do; it is just part of the business. With that should come an agreement that your client or employer will pay your attorney's fees if you're sued based on your opinion. Attorney's fees aren't cheap.

You may also want to look into getting professional liability insurance, depending on your circumstances. I know some people think that it's better not to have it and make sure all their clients know they don't have it, because they think they'll never be sued that way, but I'm not sure it's going to work. So that's something else you might want to think about.

You also want to be sure that you and the people working with you devote adequate time, energy, and resources to every opinion you provide. It is very easy to focus on the big one and let the little ones slip through the cracks, but you're going to get sued over the little ones if you do that. So make sure that everything you do gets adequate attention to bring it up to those generally accepted practices. Also, make sure that you at least consider implementing a system for some kind of prerelease peer review. The Academy's Committee on Professional Responsibility is developing a white paper on peer review that I expect will be released sometime in 1996. That could be very helpful to you in terms of figuring out how to design a peer-review system and how to implement it in your office.

I will tell you that peer review does not consist of somebody looking at your opinion and saying, "What were you thinking?" That's torture. You want to have somebody who is qualified to look the work over to make sure (1) that there aren't any obvious math errors; (2) that it makes good, logical sense; (3) that it's in compliance with professional standards; and (4) that you haven't missed anything. The reason you do peer review is because two sets of eyes are usually better than one. If you've been up to your ears in something for months at a time, you might have become so used to looking at a problem that you don't even see it anymore, but somebody who takes a fresh look at it might.

If you are in a small setting, where you don't have anyone else to look to for that kind of peer review, what you might want to consider doing is something that I do sometimes: set up your own system of peer reviewing yourself. Finish the thing several days or a week or whatever ahead of time, put it away for a while, and then pull it out and read it again. I think you'll find you see things that you missed the pass before. It's a good idea to get peer review of some sort before work goes out of your hands.

It also doesn't hurt to do postrelease peer review. I'd call it: the horse is out of the barn; how do we lock it up so it doesn't happen again? You probably cannot solve problems with work that's out of your hands, but you might prevent the same problems from occurring again.

Let me suggest to you that, with any peer review process you set up, the philosophy that seems to work best is the one that says fix the problem not the blame. If your peer review is hostile, it doesn't work very well.

Now let me say a few words about the ABCD. I know I spoke to you about it at a previous session at some length, but the ABCD has now been in operation for almost four years, and they've seen a wide range of cases. Some of them have involved statutory opinions. I really want to encourage you to use the ABCD as a source of confidential guidance when you have questions. Somebody recently said to me, "I'd be terrified to write into the ABCD." I explained to him that sometimes people have tucked an unsigned letter in an envelope and had a friend mail it in for them.

You can be your own best friend this way. We won't care. You can do that if you really are absolutely feeling panicked. Either have someone send in your request for guidance for you, leaving it unsigned, or be your own best friend and send in your own request for guidance, unsigned. We will respond to it as if responding to the person in the unsigned, sealed envelope. We'll seal the letter, and send it back off, so that if you open your own letter we won't know it. Please don't let concern about the ABCD keep you from getting the guidance you need. They're very good, they're very helpful, and they really do keep information confidential.

In conclusion, what I want to say here is that you do take on tremendous responsibility, but the opinion that you issue is very important. The appointed actuary's opinion does the public a real service, and it's important that you bring your professional judgement to serve the public through this mechanism. Try, as you work, to maintain a sense of perspective so that your judgement does not suffer, because the public really is depending on your judgement, and so are the regulators.

When all is said and done, no matter how careful you are, no matter how thorough you are, no matter how carefully you comply with standards, if money gets lost, lawsuits follow, and even the best and most careful actuary can get sued. Let me suggest, though, that the more you try to adhere to high professional standards, the more likely it is that if you do get sued, you'll ultimately prevail.

MR. BRIAN L. HIRST: Could Lauren address any unique differences in the relationship between appointed actuary and employer, as opposed to appointed actuary and client company? How does that differ from the shipping clerk who messes up and loses the truck or whatever?

MS. BLOOM: First, much of what I said was directed primarily to client/consulting actuary relationships. I think that's less true for the appointed actuary than it is in other settings, because you, the appointed actuary, are personally liable, among other things, to the regulators if you commit negligence when doing your standard valuation law opinion.

Usually I find in-house company actuaries saying to me, "Oh, I'm never going to get sued for malpractice." To some extent that is true, because the relationship between an employee and a company is such that, if the employee makes a serious mistake, the employee loses his job. When a consultant makes a mistake, the consultant not only loses the client, but probably gets sued to boot.

It's a little less likely that somebody who is in house is going to be sued by their employer. However, the valuation law is different because the valuation law makes you liable, not only to your insurance company, but also to the regulator. So even if the insurance company doesn't sue you, the regulator might.

Also, there is a significant difference here in that the statute specifically provides that you are personally liable for your own negligence regarding the opinion, at least as to the insurer and the regulator.

Until some of this actually plays itself out in the courts, all I can do is speculate. My sense is that it may be hard to argue contributory negligence, that your role was fairly limited, or that other people

were really responsible for what happened, particularly if the flaw is a flaw in your opinion, not a reflection of the work you did.

I think you still face a little more liability as the valuation actuary than you might otherwise, at least insofar as the insurer and the regulators are concerned. Also, I would say that in terms of you versus the guy in the shipping department who screws up an order, the things you are working with are of so much greater magnitude. You have tremendous responsibility, simply because of the amount of money that is involved.

MR. MARK LEWIS GLICKMAN: A couple of questions for Lauren: what legal implications are there for those who sign letters of reliance? Could you differentiate between those who are members of the Academy and those who are not? In addition, what would you suggest in the situations where someone declines to sign a special letter?

MS. BLOOM: I'm not sure I understand your question. Could I ask you to clarify a little bit please?

MR. GLICKMAN: Valuation actuaries, obviously, cannot do everything for themselves. Therefore, they have to rely on someone. They go to their assistants, or to the investment department and ask for a letter stating that that individual has prepared the data according to their ethical standards. What legal implications are there for that individual? What does that open up for them in the way of their liability? In addition, how would you suggest handling the situation where your investment officer says, "When I prepared this data, I was unaware that I had to put myself on the line. I decline to sign this letter of reliance?

MS. BLOOM: When you get the reliance letters, the authors are legally bound by the representations in those letters, and to the extent that the work that they gave you was negligently done, you can go back and sue them for their irresponsibility. (This is the kind of thing that puts lawyers in $70,000 cars.) Unfortunately, while you may be able to sue them for their negligence, the fact that you are an expert may not get you entirely off the hook. You may be able to transfer some, but not necessarily all of the responsibility to those people .

If you have a situation where someone refuses to give you a letter of reliance, I think you really have a very difficult choice to make. You can either try to review what they give you and determine whether or not it seems to be reasonable, or you can refuse to do the work until you get the letter. Neither one of those is an easy decision.

MR. E. PERRY KUPFERMAN: Someone made reference early on to the state of domicile issue. There are 50 states with 50 different sets of rules, and I am concerned as to the recommend language. Is it adequate to say that the reserves meet the standards of the state of domicile? I've seen statements issued by insurance companies that limited the language to that, and did not go on to make reference to the states in which the statement is filed.

MR. SANNING: This is a big problem because of the recommended language. It says you must meet the requirements of the state of domicile, and that, in aggregate, you must meet the requirements of the state of filing. This theoretically means that you need to go through every state where you file and figure out what the differences are between your state of domicile and the state of filing, you must recalculate the reserves to see if your state of domicile reserves meet the aggregate test.

Under the current rules and regulations, that is the way it is, and that's a tremendous problem. While it's not much help right now, there is discussion going on within the actuarial community, and among the NAIC's Life and Health Actuarial Task Force, about trying to do something about this. There is a group of four actuaries, two from the industry and two who are regulators, who are working on this problem. The Academy's Committee on Life Insurance Financial Reporting is going to try to come up with a position paper that will encourage the regulators to address this.

Regulators understand what the problem is, and I think they are open to suggestions and changes. The problem is that it helps in the future, and does not help you right now. It is a rather large problem, and you need to discuss it with your attorney.

MR. DREYER: In my opinion, these letters are still evolving and interpretations are not yet chiseled in stone. If I were in the position of not being sure that I should use the all-encompassing language, I would omit that language. If any of the other states came back to me and said, this isn't adequate for us, I would work out a satisfactory solution with them.

MR. IRISH: I guess about all I could say is I think they would come back. And I think you would find at least one state that would take you up on that.

MR. DREYER: I'm not talking about California or Illinois.

MS. BLOOM: I'd like to add something to that, also. If they accept it, you're fine for now. But if five years from now your company goes insolvent, the fact that it wasn't in compliance with the state regulation could become significant in subsequent litigation. So be aware of the fact that when you do this, you aren't just rendering the opinion for this year; you're making it for the long term.

MR. DREYER: Has anybody in this room had an insurance department come back to them and say, your statement was inadequate? [No response.]

MS. HELEN GALT: I was wondering if Lauren could expand a little bit on the comment she made about maintaining notes. I tend to maintain notes to document what I have done, to review the reasonableness of assumptions. That is not exactly the final work product. Perhaps you could expand a little bit about what you meant by that comment?

MS. BLOOM: When you do something like that, and it doesn't even have to be typed, you are building a record of what you did and how. That's a good thing to keep. Now I should tell you, different attorneys have different points of view about this issue. There are lawyers who say that the less paper you have, the less you'll have to explain. I'm not one of those lawyers.

I think its a very good idea to keep track of what you did, when you did it, and how you did it. Maybe later you and the other side will be arguing about whether what you did was adequate, but at least you won't be arguing over what you did or did not do.

Despite the fact that your notes are fairly informal, they are still final documents, in a sense, because they are documents that you are planning to keep as a final record of what you did. I am more concerned about not keeping things like the first draft of what may eventually be a 12-draft opinion, because what happens there can be insignificant. You will move words around, or you will move commas around, and often you'll make changes simply because it just looks better that way. Then later on you can find yourself in a deposition with some attorney snarling at you about why you moved the comma, and you won't remember why.

MR. MARLIN A. MUELLER: Please elaborate on how the Code of Professional Conduct applies to subordinates -- particularly with respect to staff who are not members of one of the actuarial organizations?

MS. BLOOM: It is true that the Code of Professional Conduct does not apply to your subordinates if they are not members of the organizations that have adopted the code. But if you look at the code itself, it says, in Precepts 3 and 4, that you must make sure that you and people working under your direction are qualified and meet the qualification standards. It also says that you are responsible for ensuring that your work and work performed under your direction meets the standards of practice.

So even though these people are not bound by the code, and cannot be disciplined by the Society of Actuaries or the Academy, you have a responsibility under the code to make sure that the work is in compliance. So it's a nexus with the work, not with the individual.

APPENDIX A

WHAT ARE THEY SAYING?
A Review of Actuarial Opinions

The following is based on a review of 46 1992 Actuarial Opinions filed on an asset adequacy basis (i.e., Section 8-type opinions).

Variances or notable departures from the "suggested" language of the Actuarial Opinion and Memorandum Regulation:

Section 8. B, Recommended Language

(1) Appointed Actuary's relationship with company, appointment, qualifications

No date of letter to the Commissioner
No company name (unless spacing deleted from text of Opinion copy submitted)
No name of actuary (unless spacing deleted from text of Opinion copy submitted)
No qualification statement
No statement that familiar with valuation requirements

Gave date of appointment, not date of letter to Commissioner
Attached list of states with date of letter to Commissioner
Different dates depending on year of adoption by the state

(2) Scope -- examined actuarial assumptions and methods, table of reserves

Table gave only the total reserve

(3) Reliance on others for "certain portions of the analysis"

Twenty-one responses
Reliance on various items -- cash flow and variance by scenario, assumptions relating to asset data, investment information, call and prepayment provisions, default risk, investment policies, investment strategies, interest crediting
Statement that discussed asset cash-flow assumptions, no verification of accuracy, but reviewed results for reasonableness.

(4) Appointed actuary has examined the underlying asset and liability records

Thirteen responses, one liability only

(5) Relied on listings and summaries of assets and liabilities (not examined underlying records)

Thirty-six responses, two asset only
Seven responses had statements that actuary had examined the underlying records [paragraph (4)], and had relied on others for listings
Reliance on an audit by an accounting firm

(6) Opinion statements

Six statements, (a) through (e)

- Modified item (a) to refer to "appropriate" standards
- Item (c), state requirements:
  - Stronger "this state" statement -- meets requirements of state of filing
  - No statement about state of filing
  - Added compliance with administrative promulgations
  - Referred to the NAIC model regulation
- Item (d), reserve basis consistent with preceding year: "as described by letter to the (blank) authorities"
- No item (e), provisions for all reserves were established
- Two added a "good and sufficient" provision

Reserves and related items make adequate provision for anticipated liability cash flows

- Added "principal repayments" just prior to reference to investment earnings on assets

Actuarial methods, etc., conform to appropriate standards

- Two made no such statement
- Reference to standards issued after 9/15/92
- Added reference to Actuarial Compliance Guidelines

Updated annually, no material changes

- Two stated a reliance for no material changes
- Material changes in reinsurance agreements effective on following 1/1

Impact of unanticipated events, future experience may not follow all assumptions

- Nine used "will" not follow
- Added a statement that "cash-flow portion of this Opinion" cannot follow the assumptions

Asset adequacy methods referred to in the Table of Reserves and footnotes (no significance in order):

Cash flow
Cash flow using claim run-off studies
Cash surrender scenario
Gross premium
Conservative assumptions
Development method
Loss-ratio method
Short-term nature of liabilities (e.g., health)
Risk assessment (asset and liability)
Introspective obligation risk analysis
Actuarial analysis method
Margin analysis
Comparison to tabular funds
Illiquid nature of liabilities
Policyholder bears all risk (e.g., separate account)
Not applicable, not tested, immaterial

Other statements added to the opinion (numbers in brackets, [ ], are the number of opinions, out of a total of 46, that included that particular statement):

Statements limiting the intended audience of the opinion:
For insurance department and regulatory purposes [28]
Disclaimer for any use other than intended [25]
For management [20]

Opinion is to be viewed as a whole, no part should be separately considered or relied upon [15]

A reference to the supporting Memorandum (there is concern by some, including regulators, that this could eliminate the confidentiality of the Memorandum) [14]

Opinion is a product of professional expertise, and should not be reviewed or relied upon without the advice of a qualified actuary [13]

Aggregation of reserves was the basis for the opinion [12]

Opinion is rendered pursuant to, to comply with, or to meet the filing requirements of the standard valuation law [8]

The opinion is not a statement of solvency [7]

Date of asset adequacy testing was other than December 31 [4]

Description of what was modeled (products) [4]

Reinsurance was considered [4]

Follows New York Regulation 126
(1992 Version)
Section 95.7 (b) (2) (iii)

Asset characteristics were considered [4]

Investment policy was considered [4]

Contract provisions were considered [3]

Interest crediting philosophy was considered [3]

Expenses are on a going-concern basis [3]

Cash flows varied by scenario [3]

No material changes since the testing was done [3]

No asset adequacy on employee pension business [1]

Interest earned was greater than required [1]

Assets convertible to cash [1]

AVR was used [1]

IMR was used [1]

Not a prediction of future company performance [1]

Some items to consider when preparing your opinion (this relates only to disclosures in the opinion, not to the content of the study or analysis):

Internal consistency of what is being said

Possible conflict of saying the actuary reviewed the underlying asset and/or liability records, then including a statement of reliance for asset and/or liability data.

More than just the Actuarial Opinion and Memorandum Regulation suggested topics and wording.

Some Standards of Practice to consider:

ASOP 7, "Performing Cash-Flow Testing for Insurers"

Most of the documentation on cash-flow testing would go in the Memorandum.

ASOP 11, "Treatment of Reinsurance Transactions in Life and Health Insurance Company Financial Statements"

A statement should be made as to whether reinsurance was reflected in cash-flow testing.

ASOP 14, "When to do Cash-Flow Testing for Life and Health Insurance Companies"

A statement should be made as to whether cash-flow testing was done, and if not, why not. It would be informative to also include a short description of what was tested.

ASOP 22, "Statutory Statements of Opinion Based on Asset Adequacy Analysis by Appointed Actuaries for Life or Health Insurers"

An opinion should be provided to the board/management, but some have a qualification statement that the opinion is for regulators only.

ASOP 23, "Data Quality"

The extent of reliance should be disclosed, including the extent of review by the actuary. (The actuary should be satisfied that the information relied upon is reasonable, *ASOP 22*.)

Practice Legal Note:

Question on reducing the possibility of misuse of the actuarial opinion.

Describe purpose of opinion
For whose use was it prepared
Disclaim responsibility if other parties attempt to use it for purposes other than that for which it was intended.
Opinion should be viewed as a whole, no part should be separately considered or relied upon
A product of professional expertise, should not be reviewed or relied upon without the advice of a qualified life actuary

New York Regulation 126 (current)

There are some differences in suggested topics and wording that you might want to consider.