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First it was the doctors, then the directors, then the accountants. Are insurance actuaries next on the malpractice hit list?

Faulting the fortune-tellers

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By Richard Morais

In the fall of 1942, desperate to stem the devastating losses of British-bound convoys, the U.S. Navy turned for help to 18 actuaries. Perhaps, by analyzing statistics of the sinkings, the number crunchers of the insurance industry could uncover the strike patterns of U-boat wolf packs and so discover safer convoy routes. (Ultimately, the British would solve the problem by cracking the Enigma machine, which produced the German military code).

That was about the most exciting thing to happen to actuaries for the next 43 years. Until now, that is. Now it's the insurance industry itself that's under attack. And it's the actuaries who may catch a lot of the flak.

The reason is that price-cutting swept the property and casualty field for five years, leading to staggering underwriting losses in the longest and most severe down cycle in history. It is the actuaries who are charged with making the statistical projections on which pricing, reserving and underwriting decisions are made in the insurance industry.

Are actuaries next on the malpractice hit list? There are some indications of it — a recent suit, for example, by the Pension Benefit Guaranty Corp. against George B. Buck, a nationwide actuarial consulting firm. The suit alleges that Buck used unreasonably optimistic actuarial assumptions when calculating the probability of plant shutdowns at Mesta Machine Co. The PBGC was forced to cover the pension shortfall when the plants actually shut down in 1981–82.

Actuaries are coming under fire on a variety of points. Many underwriters suspect that supposedly neutral actuaries all too often adjust the results they show underwriters to suit top management. Alfred Weller, chief actuary for insurance brokers Fred S. James, dismisses such talk, saying that it's based on a misunderstanding: Actuaries will sometimes, for example, leave out of the underwriters' books the investment income in a CFO's books. The idea is not to allow underwriting judgments to be influenced by a firm's investment considerations.

Then there's the notion actuaries are ivory-tower technicians with no real business experience. Says Chairman Andrew Barile of reinsurance brokers Andrew Edwards & Co.: "I told one company their projections were based on what happened the last five years. The man had not spent an ounce of his time talking to people on the street."

Talk to actuaries, however, and you get a different story. They say the main culprit is often top management overriding their calculations. Says Regina Berens, an actuary at Prudential Reinsurance: "In some companies you get managements that say, 'The reserve is too high; that will kill our bottom line. You guys are always overcautious with your doom and gloom predictions, so we're going to set it $3 million lower.' It's common-place."

One might think actuaries have sufficient academic credentials to stand up to such pressure. The 11,000 U.S. actuaries, most of whom work in pension- and insurance-related fields, can spend an average of ten years learning their trade. That's right up there with the brain surgeons. They take a ten-part exam administered by the profession's two societies. It's tough: The passing rate is about 40% for any one part.

Painstaking analysis is what they are famous for. Suppose Prudential's Berens were called in to reevaluate the adequacy of fire insurance reserves in light of recent Argentine losses. She would have to educate herself about Argentina's history and business conditions, recent court settlements and exchange-rate history. Then she would crank all that into a mathematical model and come out with an estimated range of reserves that would cover all possible loss payouts on Argentine risks.

Despite all the analysis, actuaries remain open to malpractice suits if projections prove to be way off. Says Stanley Hughey, president of the American Academy of Actuaries, "We don't like getting sued. But we think it's going to happen."

Concerned, the academy is moving to publish formal standards of practice for the profession. Another solution: Require actuaries to submit an independent report to the company's directors and give them more power to stand by their projections. If actuarial societies don't do this, someone else will: The Big Eight CPA firms continue to beef up their actuarial staffs, and for CPAs the threat of lawsuit is only too tangible. □

AWARD TO COLLEGE STUDENT SHOWING PROMISE AS AN ACTUARY

The Adirondack Actuaries Club has selected Michael Kerner as this year's recipient of the Club's $500 award for the college student who shows the most promise for an actuarial career. Mr. Kerner, a senior at the State University of New York at Binghamton, will graduate in May 1986 with a double major in mathematics and economics and plans to pursue a career as an actuary. He was selected for passing the first two parts of the Society of Actuaries Examinations and for his outstanding academic record. □