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LUNCHEON PRESENTATION

Professional Responsibility

W. James MacGinnitie

PROFESSIONAL RESPONSIBILITY

MR. STEVEN A. SMITH: Our luncheon speaker is Jim MacGinnitie. Jim is a Past President of both the Casualty Actuarial Society and the American Academy of Actuaries and is currently a Vice-President of the Society of Actuaries. Most importantly, however, he is Chairperson of the Academy's New Committee on Professional Responsibility, and he's going to speak about the activities of that committee.

MR. W. JAMES MACGINNITIE: I feel a little bit like I'm preaching to the choir here. In an environment of failed companies, of uninformed rating agencies, of newly awakened regulators, and of multiplying lawyers, I doubt seriously that there's any group of actuaries, or any other profession for that matter, that takes its professional responsibility more seriously.

As Steve said, I chair a committee, which is about a year old now, of the American Academy of Actuaries on the topic of professional responsibility and many of my remarks will be related to the activities of that committee. I apologize to the Canadians for the American focus to my remarks, but there is a parallel effort in Canada and we maintain good liaison with that group. As a matter of fact, there are several excellent ideas that have been developed in Canada that I'll make reference to.

I'll start with a thumbnail description of the challenge that we face in the area of professional responsibility. We have an accelerating rate of environmental change. In recent months, we've seen the unprecedented collapse of several large life insurers, and we've seen a depressed market for real estate prices of a depth and length of time that's also unprecedented. We have the failures in the savings and loan and the banks and their spillover into the insurance business, at least by association, and by their corruption of the word *insurance* when it refers to FDIC or Federal Savings and Loan Insurance Corporation (FSLIC).

We have the phenomenon of Proposition 103 in California with an elected commissioner. That affects not only the automobile insurance business, but also the business that most of you are

concerned with. And we have the precarious finances of the PBGC. All of these are major problems that face the institutions that we, as actuaries, serve.

We also have had, in recent years, a rapid program to formalize our standards of practice. Certainly the Actuarial Standards Board has been producing material for your in-box. We have changes in the continuing education requirements, which may be the reason why some of you are here, that are part of a larger movement relating to qualification standards. We have a revised code of conduct that is in the process of being adopted by the various actuarial bodies, and we have a new Actuarial Board for Counseling and Discipline that has been adopted by the Academy and will be utilized by most of the other U.S. actuarial bodies.

We also have, as a profession, some new admission requirements. The Fellowship Admissions Course is a little more than a year old in the Society of Actuaries. I've been privileged to serve as a facilitator in that course, as have several of you. It's an outstanding course. It includes some very interesting material on professional responsibility and on ethics that constitute a new requirement for getting into the profession.

The parallel move on the part of the Casualty Actuarial Society is the creation of a new professionalism course. It's required for new Associates.

But most of you, as current members of the profession, got in before we put these requirements in place. So you're part of what we refer to in my committee as the "unwashed 10,000." And even while the Fellowship Admissions Course is an outstanding course, it's still fairly elementary, and it's very early in the actuary's career, coming as it does at the entry into the profession. And there are some actuaries who will never be exposed to the course, at least as it's currently constituted, because they'll become permanent Associates, or because they'll obtain their membership in the Academy by virtue of their Enrolled Actuary status. So while we have this new admission requirement for most actuaries, it doesn't cover everyone. It hasn't

covered all of you, and because it's early we have a need for continuing education in professional responsibility.

Another part of the challenge, as the committee perceives it, is the anecdotal evidence of ignorance and apathy with respect to standards. The Actuarial Standards Board receives relatively few comments on its exposure drafts, and there's a relatively low level of involvement in the drafting of those standards, at least in comparison to what happens in the Education and Examinations Committee, for instance, where 15% of the Fellows are involved. Also, we occasionally hear the comment, "Those standards are not for me; they only apply to consultants or to chief actuaries. It's not part of my job." Now, attendees at a seminar such as this are not part of that group and you can be proud of that. But we do have some evidence of incomplete actuarial opinions being filed. At least anecdotally, some of the states tell us that the opinions they receive are not complete. Most often mentioned is the failure to say anything about cash-flow testing.

We also find that there are many actuaries who work in small or solo settings. I refer to them as the "lonely actuary." That can happen even in a big company or a big consulting firm. If your assignment doesn't keep you in regular and vigorous contact with other actuaries, you can be operating in a lonely manner.

Finally, as part of the challenge that we perceive in the committee, we have the observation that the standards and the guides are not very user-friendly, which impedes access and familiarity. How many of your binders put out by the Actuarial Standards Board are current? Or have you just collected all those little booklets in a pile to be looked at, sooner or later? How many of you have actually studied the standards that apply to you? Again, I would think that this group is probably a biased sample. You're probably more aware because you're spending a fair amount of time at this symposium to become more familiar with some of the standards and their applications.

We've concluded in the committee that we need to find some ways to make the guides and standards more accessible, more user-friendly. We're suggesting that we try to adapt some new technology and make them available on a disk, with key-word-search capabilities. That's one of the potential actions that the committee is looking at.

I'd like to turn now to a discussion of some other potential actions, dealing first with the actions that will increase awareness.

One way to increase awareness of standards and guides is to work them into the content of our meetings. Special sessions are a good example, as are workshops at the regular meetings. Also, we are trying to work standards and guides into the content of regular sessions. That is, if we're talking about a particular topic, we can also talk about the relevant standard of practice, as a way to increase our awareness. Our perception on the committee is that if we go to special sessions or even special meetings, they'll have very limited appeal and we'll end up preaching to the choir.

Before I joined my current firm, I taught at the University of Michigan, and one of the enjoyable things that I was able to do there was organize brown bag lunches for the students to talk about actuarial ethics. We had some of those little half-page vignettes that I'm sure many of you have seen. We use them also now in the Fellowship Admissions Course. In a half-page an ethical dilemma is sketched that provides a basis for discussion of how the actuary should respond to that dilemma. The problem, of course, is twofold. First, the world never presents itself in a half-page vignette. It occurs a little bit at a time, over an extended period of time, and if you would only stop at any moment and write down the half-page summary of what's happened, you might very well reach a good conclusion. But it doesn't happen that way. Those of you who have heard the interview with one of the Equity Funding actuaries know that it was just one little step at first and then another and another and pretty soon he was rapidly descending the slippery slope.

The other problem with my experience at Michigan was that only about a third of the students came, and I think it was probably the wrong third. I think it was the third that didn't need to talk about ethics because they already had good instincts. It is the others that I worry about out there in the world.

Another way to increase awareness is in the content of our publications, including our newsletters and the magazine *Contingencies*. Items, such as reports on the activities of the Discipline Committee, discussions of new standards, discussions of hypothetical ethical situations, can all help to increase our awareness. Including standards in the content of the examinations is another way to increase awareness. Virtually all of the adopted standards and several of the exposure drafts have already been worked into the study material on the examinations.

In general, in all of these areas -- meetings, publications, and exam content -- the support of the various volunteer committees and of the staff of the Society and of the Academy has really been extremely helpful. Our challenge now is to maintain a steady level of this activity, not over a few months or even a few years, but for a long time into the future.

Another awareness activity that we're suggesting is some kind of exhortation or reminder to the chief actuaries. The committee will be communicating directly with the chief actuaries, urging them to be more involved themselves, particularly in the drafting and the responses to the drafts of new standards. Also, we hope they will provide internal emphasis within their organizations. We want to suggest very strongly that the chief actuary is particularly responsible for the others in his firm or his company. We also hope to develop a kind of exchange of approaches to the topic of peer review and what's worked and what hasn't worked and how. Within his own environment, a chief actuary can achieve a higher level of peer review and the professional responsibility that that entails.

Those are all activities that relate to increased awareness. Another thing we think we need to do is increase commitment. There's the old story that the difference between involvement and commitment is the difference between the bacon and the eggs on your breakfast plate: The hen was involved, but the pig was committed. We think we need to increase the level of commitment of the actuaries to their professional responsibilities. One place to start is with the initial examinations. When you sign up for the early exams now, it doesn't say anything about professional responsibility, and we're recommending that appropriate language be incorporated in that application.

We're also very enamored of an idea that I'd appreciate your feedback on because, while we want to pursue it aggressively, we see some administrative difficulties, and we need the help of the rest of the profession to deal with these. It's an idea that's been borrowed from the CFAs, the Chartered Financial Analysts, and it essentially involves an annual self-certification of your awareness and your compliance with the guides and standards. It's kind of like an annual pledge card, if you will.

We're wrestling with some of the operational difficulties. For instance, would this best be included with the dues notice so that, when you remit your dues, you're also sending in your annual awareness and compliance signature? Or would it be better to have it separate so that it would perhaps receive a little more attention, a little greater pause and reflection, before you signed it? What do we do with the people who don't return it, even after repeated requests? What do we do with the people who return it mutilated or refuse to sign it? Out of 10,000, we're going to get a few. The CFAs initially adopted a policy of expulsion after two years of noncompliance, and that may make sense for us and it may not. Those are questions that we're wrestling with. Also, what kinds of responses noting non-compliance might end up being referred to the Actuarial Board for Counseling and Discipline?

A third area beyond awareness and commitment is what we refer to as compliance, and this is an area that the Canadians have pursued very vigorously. Our view is that in the United States

today the police are sitting in the station house and they're waiting for somebody to come knocking at the door. The question we raise is, should they get out on the beat? Should they be more aggressive in enforcing the standards that we have? Should they review filed opinions for apparent compliance? Should we encourage regulators to report exceptions?

In Canada, they've gone to a compliance questionnaire, and the actuary who signs the life company valuation there has to file a questionnaire with the CIA. It's very detailed. It's not an "I did what I was supposed to." It's reviewed by committee. It's mandatory. Canadians are proposing to do a mandatory questionnaire with the casualty blank as well. That's an idea that we've looked at. I think it's fair to say that the committee is not as enamored of compliance questionnaires as the Canadians are, but it's difficult to dismiss the idea when it's being so vigorously pursued north of the border.

We've also looked at what the CPAs do with the mandatory peer review, and I'd tell you that we're not real enthusiastic about that, but we are looking for ways, as I mentioned earlier, to encourage good peer review within larger organizations and some practical and economical means of providing peer review to those lone actuaries who feel the need, and want to have access to, some kind of support in that peer-review function.

That's pretty much what's happened in my committee in the last year. I'd like to move on to some broader questions about professional responsibility. This last point, on compliance, is perhaps a good transition, because I think as actuaries we have a tendency to view compliance with all of the articulated rules and standards as fulfilling our professional responsibility. That's perhaps most apparent when you look at what goes on in the pension world where, because of the many regulations promulgated by various governmental bodies and quasi-governmental bodies like FASB, you just get so bound up in complying with all of the rules that you think you're done when you're safely threaded through them all. I suppose Regulation 126 has some of those characteristics as well.

I think what we really need is a much larger perspective. Let me list some examples of the situations that I would suggest require that larger perspective. I have no doubt that the projections that were done on some large GIC writers and annuity writers were done in a technically correct manner, but I really wonder whether the range of alternatives that were looked at was wide enough. Did they include the depressed real estate markets and high yield securities markets that we see today?

On the pension side, the parallel is those recommendations about where to place the settlement annuities. Did they give enough consideration to the financial solidity of the carriers that were bidding? In my own field, long-term, workers-compensation reserves are a terrible problem, and I think in some cases actuaries have not given sufficient consideration to the inflationary pressures on health care costs -- a problem not unknown to those of you who work in the health care insurance fields or to the actuaries who did the pricing on Medicare originally and perhaps many times since.

Another example from my own field is the long-tail liability problems that we have in this country. When we set the prices for those coverages, did we give enough consideration to the terrible problems of asbestos or environmental impairment liability? Fifty years ago, the profession was dealing with major problems in long-term disability insurance when too little consideration had been given in some pricing and reserving to alternative economic scenarios that included a prolonged depression.

Two decades ago, in Social Security, the benefits were indexed to the cost of living, while the tax income was indexed to the wage base and even that with a cap. At the time, everybody thought that wages would go up faster than cost of living, and the fund would remain in good balance. Unfortunately, the range of scenarios considered wasn't wide enough, and we ended up with a problem and had to make some changes in the Social Security system. PBGC was put into place with a modest premium and what, in retrospect, was insufficient consideration of "moral hazard" and the problem of declining industries.

Now, in all these cases I have no doubt that the mathematics were correct. The calculations were done properly, but the assumptions of the parameter values were, in retrospect, too optimistic. I think that points out one of the problems we, as a profession, face. We are, in the final analysis, engaged in the business of predicting and forecasting, but too often we try to cloak that with the scientific jargon and the mathematics that make the analysis sound very precise, and we end up not fulfilling our true professional responsibility.

I think we have a professional responsibility to make it clear that we are forecasting, that this is a prediction, and not hide behind that special vocabulary, not hide behind those complex mathematics and the wonderful charts that we can do with all the wonderful software that's come into being in the last decade. It's difficult to forecast the kinds of events that I just alluded to: collapse of asset values, a run on the bank, a cost of living growing faster than wages, the rate of inflation in medical costs, and the decline of an industry. This is never pleasant. Think of telling a client that you think his industry is declining and his pension plan is in trouble, or telling a client of the court decisions that bedevil his liability reserves.

One of the accounts that I've had the privilege of working on for close to 20 years now is the medical malpractice account for the doctors in New York. I'd defy any of you to take the data through 1974 and extrapolate them in any meaningful way to tell me what happened in 1975, 1976 and 1977. You can't do it. You would have been laughed out of any responsible forum if you had done it. Yet that created real chaos in New York. It ended up with doctors on strike and refusing to provide essential services, and the creation of a joint underwriting association. It has ultimately led to some tort reform and some turnaround. But there's no way that any responsible predictor or forecaster could have looked at those data and predicted what was going to happen. I think it's unpleasant, but occasionally, and certainly more often than we do now, we have to deliver the message that what actually happens may differ, perhaps significantly, from what we've calculated, from what we've projected, from what we have forecast.

Another broader issue that I think bears comment is the question of the legal environment. We operate in a legal environment that is very difficult. We're talking now about professional responsibility. *Profession*, as you are probably aware, is a sometimes misused word. There's probably not an occupation in the country that doesn't want to call itself a profession, and that inevitably, I suppose, leads to some disputes among the professions.

One of the hallmarks of a profession is the primacy of the obligation to the client, and that's one of the things that makes us vulnerable in a very peculiar manner to the chaotic legal system we work in. We must answer questions such as, Who is our client? Is it our employer? Is it, in the consulting case, our clear and identified client (the one who's paying the bill)? Is it a stockholder? Is it a policyholder? Is it a plan beneficiary? Is it a regulator? Clearly the regulators, through the valuation actuary movement, are pushing to make themselves our clients in many regards. Is it the tax authority? All of these have some claim on the word *client*, and that ends up requiring us to keep our several clients, both the direct ones and the indirect ones, in mind as we do our work, and to maintain an appropriate balance. But the lawyer has only a single client, because he has very strong conflict-of-interest rules and he can only represent one of them. He also has the benefit of hindsight or, as my medical clients refer to it, the retrospectiscope, and that gives him, with those two benefits, the ability to attack us, sometimes very successfully. His training is not rooted in science, as ours is. His training is advocacy and his professional standards reinforce that advocacy with a vengeance.

You then factor in actuaries' real dislike of cookbooks, which has led us to leave as much room as we can for informed professional judgment, and you have a recipe for a piece of very difficult litigation. We put the word *reasonable* in a lot of our standards. The lawyers tell me that as soon as they see the word *reasonable*, they know that there's not a judge in the land who will keep them from taking that question to a jury. Was what the professional did reasonable in light of all the circumstances? With the benefit of hindsight, and the benefit of advocacy, the answer can easily be "No."

My point is really a very simple one. We're being asked to discharge our professional responsibilities in a very difficult environment. It's one where our predictions or forecasts are difficult, where sometimes events are going to exceed even the most pessimistic of scenarios that we can reasonably paint and certainly that we can paint in the commercial environment as employees or consultants that we have to work in, where some of that range is going to be unwelcome, and where the legal system is going to hold us accountable.

There are no easy answers. I can only refer you to Ambrose Bierce's entry in his *Devil's Dictionary* on accountability, which he defined as "the mother of caution."