1993 VALUATION ACTUARY
SYMPOSIUM PROCEEDINGS

LUNCHEON ADDRESS

Assuming the Mantle of Professionalism

Walter S. Rugland

LUNCHEON PRESENTATION
ASSUMING THE MANTLE OF PROFESSIONALISM

MR. WALTER S. RUGLAND: In 1992 the U.S. joined Canada, Australia, and the U.K. in broadening the range of responsibilities actuaries have in the financial management of life and health insurers. As you know, revisions to the standard valuation law created the position of appointed actuary. Clearly this changed the actuary's role in valuation.

What led up to this significant change? I think it is because the actuarial profession has come of age! We are ready to take a leading role in keeping our businesses and financial systems strong. We are ready to help solve any business problem involving financial risk. We are ready to say, "Ask An Actuary."

Today I am speaking as both President of the Society of Actuaries and as a professional volunteer who has participated in the development of the profession over the last 15 years, and I want to discuss the building of the actuarial profession in North America.

What Is a Profession?

First, I will define the concept of a profession, and then I will describe the evolution of the actuarial profession in North America, then the U.S. appointed actuary as a case study. I don't mean to discuss the duties of the appointed actuary, but rather how that position is consistent with the role of actuaries as members of a profession.

Let's first examine the concept of a profession. The American Academy of Actuaries is the organization in the U.S. with the responsibility for representing all actuaries in public policy and governmental relations matters. In the late 1970s, it appointed a committee to examine whether it should provide guidance for members so that when an actuary spoke, the American public could be assured there was an adequate knowledge base behind that statement. In other words, should actuaries in the U.S. establish a self-regulatory mechanism known as standards of practice? The North American actuarial organizations already had codes of professional conduct and discipline processes with respect to observing these codes. The difference, however,

between a code of professional conduct and a standard of practice is important. A code is general in purpose, while a standard of practice is precise for a particular situation; a code is mandatory, but a standard may not be. In addition, because the codes that existed were not consistent from organization to organization, there was potential for an actuary who belonged to several organizations to be disciplined by one but not by another.

This committee defined a profession in general as follows:

> A profession is a vocation founded on specialized educational training, the purpose of which is to supply disinterested counsel and service to others, for a direct and definite compensation, wholly apart from expectation of other business gain.

This definition implies that, for a profession to be recognized as a profession, it first must be organized within a professional body. Second, its members must adhere to a standard of competence and a code of conduct enforced by that professional body.

This means that a member of a professional body will find professional activity subject to peer evaluation in two distinct areas: ethics and quality of work.

Let's examine the area of ethics. A professional should conduct professional affairs in an ethical way. A professional should only accept assignments within an area of personal competence. A professional must be honest. The work of the professional must be complete. The professional must consider and address any potentially misleading aspects of the assignment. Now, consider quality of work. It is essential that a professional produce high quality work. The professional must correctly use acceptable and appropriate techniques.

It then follows that, for a profession to be recognized, it must provide its members a structure of support and protection. In return, its members must adhere to rules of competence, codes of professional conduct, and standards of practice that are established and enforced by peers. This applies whether a professional is working independently, in a consulting role, or as an employee of an insurer, bank, or other institution.

If we think about a profession, its basic attributes include the prerequisite of research and education. This embraces the nurturing of a science, an art, or a skill, requiring continuing research and education. Then follow:

- membership status;
- a code of professional conduct, which indicates appropriate behavior when acting as a member of the profession;
- standards of practice, which provide assurance to the public that, when a professional function is executed or a professional opinion is promulgated, the work product of the professional can be relied upon;
- established qualification or competency standards, which indicate the education and experience necessary for a member to undertake a specific assignment;
- a discipline process by which peers will judge, when appropriate, whether the code of professional conduct, the standards of practice, or the qualification standards have been observed by a specific member.

In short, a profession requires that:

- members follow a behavioral code;
- members know the appropriate process for performing their professional work;
- members meet education and experience requirements, which result in presumed competency; and
- members assure compliance of other members through a discipline process.

Life Insurer Valuation

Now let's look at U.S. life insurer valuation prior to 1970. I define valuation as the establishment of benefit liabilities (reserves) on an annual basis, for the statutory balance sheet of the life insurer. That balance sheet is prepared according to accounting rules established by regulatory authorities governing the life insurance business. In some instances the accounting rules are established for other purposes; e.g., by tax collectors for tax collection bases, or accountants who serve the investing public.

Here, we are interested in the statutory balance sheet.

Prior to the mid-1970s, life insurance reserves in the U.S. were established based on laws developed in the early 1940s. We call these the Guertin Laws, named after an actuary who chaired a committee of distinguished actuaries. As the world was recovering from the Depression of the 1930s, this committee realized that a new basis for life insurance company reserve methodology was needed. New laws requiring reserve methodology were set state by state, and these became the basis of regulatory valuation. It seems to me that the Guertin laws were built on the following set of assumptions:

- Dollar values would be constant, and essentially purchasing power would be level over all years in the foreseeable future.
- Interest rates would be essentially predictable, if not steady, over that entire future span. Their relative positioning would remain constant -- long-term rates higher than short-term.
- Since life insurers would always make long-term promises, the focus should be long term in nearly all operational aspects.
- Life insurer sales activity would be manageable.
- Life insurers would be the sole providers of protection in the event of death and disability.
- Taxes would be as they currently were.

As I mentioned, these assumptions were locked in law state by state. Reserving became a mathematical exercise of applying factors defined by law to face amounts of business on the books. It was a time-consuming calculation. For some reason, it required exactness. Overall, determining the liability was laborious, but little professional judgment was involved.

My father was an actuary. As a child I remember the months of January and February being extremely difficult in our family as he labored over the preparation of reserves. This was before much electronic equipment, and it required an enormous amount of calculating.

Actuaries always checked for exactness as well as reasonableness of reserve calculations. However, the actuary did not take professional responsibility for the adequacy of the reserves. No signature or testimonial was required to indicate that the reserves were appropriate relative to the benefits promised.

The profession at that time consisted of the Society of Actuaries, the Casualty Actuarial Society, and the Conference of Actuaries in Public Practice. These organizations did not negotiate with the regulatory authorities.

Actuaries in the Public Arena -- The leaders of the profession, however, realized that actuarial judgment was something that should be nurtured. In the mid-1960s, these leaders worked together to create two organizations in North America to communicate with regulatory authorities and to promote the "profession" of actuary in the public arena. In Canada, this resulted in the Canadian Institute of Actuaries. In the U.S., it was the American Academy of Actuaries.

These organizations work today to establish themselves as the credentialing bodies for actuaries. The Canadian Institute of Actuaries was fully recognized by regulatory authorities in 1978. Fellowship in the Canadian Institute is the legal definition of an actuary in all respects.

In the U.S., many attempts were made at the federal government level for a charter for the Academy. This charter would have provided for recognition of Academy membership as evidence that an actuary was subject to standards that could assure the government and the public that good work would be done.

This effort was unsuccessful until 1974, when the Employee Retirement Income Security Act (ERISA) was passed in Washington. This Act established a nationwide regulatory basis for employer-sponsored pension plans. It also established a role for actuaries with respect to pension plans.

The profession, however, was not ready to assume its professional role. As a result, the ERISA law established a Joint Board for the Enrollment of Actuaries. It said the federal government would be responsible for identifying qualified actuaries and for establishing standards with regard to actuarial duties prescribed under ERISA.

The lesson we learned in the U.S. was this: if actuaries wished to be assigned professional duties, the attributes of a profession must be associated with its organization. At the time of ERISA, these attributes did not exist. Because of that, they were then dictated by federal regulation, and the profession was now partially under the direction of the federal government.

Life Insurer Valuation -- The next event was a movement within the U.S. life and health insurance regulatory arena to require an actuary to render the opinion on whether the reserves established on the regulatory balance sheet make "good and sufficient" provision for the guaranteed benefit obligations the insurer had assumed. This was done by the NAIC through the Instruction Rules Section of statutory financial statement filings to state regulators. It was an additional technical requirement which put the actuary in a professional mode. Not many regulators knew what to do with this opinion when it was presented; they did not consider actuaries as professionals.

The Academy developed recommendations as to how actuaries should proceed when they give the opinion. Over the next decade, there were very few situations where a regulator challenged the work product of an actuary who had provided such an opinion. In fact, discussions and in-depth analyses indicated that regulators did not look at these opinions, having indicated they had no value.

Better progress was made in Canada. Statutory changes in federal law required the opinion and report of an actuary with respect to the liabilities established on the balance sheet of companies in Canada. The title of valuation actuary emerged, and the responsibility was defined by federal statute.

In the U.S., the Academy began to work on establishing qualification and practice standards. I have discussed one of the committees involved in that work. Another committee was the Committee on Qualifications. It was created to help members determine the qualification level necessary to satisfy public expectations.

Academy membership was broad based, and not every Academy member was qualified to undertake specific assignments. In fact, no Academy member was deemed qualified just by membership. Members determined their individual qualification based on how they understood each assignment. It was for this reason that qualification standards became so important to the profession.

Since membership and qualification compliance were presumed to mean that an individual was qualified, standards of practice then needed to be specified as well.

Product Revolution -- In the late 1970s, a revised approach for establishing liabilities to U.S. life insurers' balance sheets was proposed. When adopted, it was called the 1980 Amendments to the standard valuation law. The law established a new mortality basis and a dynamic interest approach with respect to the ongoing application of the law -- where factors would change depending on interest rate variations at the time of issue of contracts.

Because this proposal was a significant change from the laws of the early 1940s, analysis by an advisory committee supporting the regulatory authorities was needed. The advisory committee consisted of actuaries. While it recommended adopting the proposed legislation, it also warned that the legislation only maintained a status quo for a set of assumptions that were appropriate in 1940. The committee noted that the original premise of the standard valuation law, still in place, was no longer valid and could not be relied upon in the same manner under which it had been developed in 1940.

A major factor of change was the deregulation of interest rates in the U.S. in 1979. Also, the market had become more diverse, and many products were being designed that were not readily

valued under the framework of the old law. Universal life is the prime example of this type of product, but GICs, as well as annuities for individuals, caused similar concerns.

The advisory committee called for extensive actuarial research to better understand the risks of inadequate premiums, asset default, and inappropriate liquidity with respect to coordination of asset availability with obligation payments.

A focus of the 1980s was a series of responses by the profession to the call for a new valuation law for life insurers.

Wanted: A Professional Actuary -- It was apparent early in the decade that, even if actuaries knew how to evaluate risk, and even if actuaries wished to assume professional responsibility for the adequacy of benefit liabilities, the public, and especially the regulators, were not interested in talking to us. They had no basis to rely on our work.

Often mentioned was that no meaningful process existed to discipline an actuary who did not comply with the conduct code of the profession. In addition, no refined mechanism existed to assure the public that the actuary was qualified for specific work. And there was no real basis upon which appropriate methodologies had been identified for doing the work. Such methodologies were needed for a discipline process to function. We responded.

While the Society of Actuaries and Casualty Actuarial Society were conducting research on risk, the CIA and the Academy were working to establish a system of appropriate practice standards. This process took many years, but the final result was the establishment of the Actuarial Standards Board (ASB) in the U.S. and CIA guidelines in Canada.

The ASB establishes standards of practice in those areas that it deems appropriate for the public good. It provides actuaries the basis for determining appropriate methodology and approaches to assumption setting. It is also where actuaries can look for safe harbor when the appropriateness of their work product is challenged.

While the ASB was being developed, an intense effort was simultaneously under way to establish a reliable basis actuaries could use to determine if they were qualified to undertake a given assignment. That effort resulted in the late 1980s in a revised approach for standards of qualification. These standards apply to actuaries who opine with respect to regulatory responsibility or who are complying with standards of practice, or responding to actuarial assignments required for clients to comply with government or quasi-government regulations. A general qualification standard was adopted. For some specific duties, such as opining on reserves for insurers' balance sheets, specific supplementary qualification standards were also promulgated. This process is used today.

So, as a profession, how are we doing? We had a code of professional conduct established in the 1960s, we had a process of producing standards of practice, and we had established an approach for determining qualification with respect to competency. Important to note with respect to standards of qualification, one of the requirements is that an actuary must personally attest in reports submitted to employers and clients that standards of qualification are satisfied.

During the late 1980s, a concerted effort was undertaken to strengthen the profession overall in North America. Two major conclusions arose from that effort. One was to establish a revised code of professional conduct for behavior. Concurrently, a more formal approach was also developed to investigate charges of noncompliance with both that code and standards of practice and qualification.

In the U.S., this resulted in a uniform code of conduct adopted in principle by all the actuarial organizations, and the establishment of the Actuarial Board for Counseling and Discipline. This board is charged by all the organizations to investigate complaints against actuaries with respect to their behavior, their qualification or their work product in the U.S.

In developing these attributes of the profession, one additional component was required with respect to qualification. It seemed to have been always assumed that the examination process was all that was necessary and available for an individual actuary to be qualified under an

education rubric. It became apparent, however, that continuing education providing professional updating on issues, methodologies, and approaches to assumptions was also needed. And so, required continuing education became part of the qualification standards.

In Canada, the attempt by Parliament to restructure financial services has placed significant pressure on the actuarial profession to stay at the forefront in providing professional opinions on future contingent events. The scope of this is not yet fully understood. However, the Financial Services Act in Canada has set the stage for actuaries to have broad-ranging duties. In the next few years, it will be interesting to see how much will come to the profession with respect to fulfilling some of these potential assignments. We know that none would come if actuaries were not thought to have a strong professional base.

Life Insurers' Valuation -- Now we come to 1990. As you know, several major insurers in the U.S. failed to anticipate risks and maintain appropriate statutory balance sheets. Supervisory authorities took them over, placing in doubt the realization of expected benefits by policyholders. This has been a real challenge to regulation. Was regulation structured appropriately for the fast-paced life of current times? Members of Congress and other Washingtonians began to challenge its effectiveness. They put immense pressure on state authorities to assure more forcefully that insurer promises to policyholders would be kept.

The actuarial profession had addressed the issues of professionalism in the 1980s. We were ready to take more responsibility for assuming the adequacy of reserves. However, to do that professionally, the statutes had to be changed to provide that the profession have the duty to establish standards of qualification and practice and be able to operate a discipline process. The profession also said that actuaries should be recognized by law with respect to addressing the future with respect to current unknowns and be protected from unknowledgeable challengers. Since U.S. legal liability theory was ignorant of this role for the actuary, the profession said actuaries must be protected from frivolous liability claims.

All of these conditions were met in the development of the model 1990 standard valuation law and related regulations.

Why did this change in the actuary's valuation role happen? It is because we could respond; because we now have a real profession. We have a code of professional conduct, standards of practice, qualification standards, continuing education requirements, and an effective discipline process. And as a profession we are also conducting credible research and education.

In Canada, recent Parliamentary actions have called for additional actuarial responsibility. Not only are actuaries to assure professionally that reserves are adequate; but also they are to report to management that company assets adequately support both existing business and the company business plan through a reasonable range of future economic scenarios. This development is significant, and it does not exist elsewhere in the world. SOA members are doing this work.

The Future -- So, how is the actuarial profession poised for the future? In Canada, the profession is well recognized, and it is established in law. Most important, it is trusted. In the U.K., it is respected and its advice is both welcome and sought on many financial issues. In Germany, a new level of professional qualification based on exam-type criteria is being set up. In Mexico, actuaries are a leading corps of professionals. In the U.S., the profession has become recognized in part by statutes, such as the new standard valuation law. This law assigns appropriate responsibilities to the profession, including determination of methodology, approach to assumptions, and setting of qualification standards.

But the U.S. role is still confusing. Although we have a profession, we still have too many diverse views and practices. Many actuaries do not embrace all the precepts of professionalism. They wish to default to regulatory edicts and instruction.

In addition, we as actuaries are still not professionally addressing all the risks. For example, ERISA has a narrow definition of actuarial duty. And while the 1990 standard valuation law says that appointed actuaries should opine on reserve adequacy reported on the statutory balance

sheet, the appointed actuary's review does not apply to the entire balance sheet. Developments in 1991 established a role for casualty actuaries to opine on the appropriateness of loss and loss expense reserves, but again, this does not apply to the entire statutory balance sheet. The U.S. profession must decide if it should initiate professional responsibility beyond that required by statute.

The Academy resolved in 1991, at the urging of the Board of Governors of the Society, that it must be prepared for further professional developments with respect to future solvency of insurers. The Academy's Board of Directors has adopted a position it will advocate if asked to participate in addressing the issue. This position is not unlike what already exists in Canada. However, time is needed in the U.S. for insurance company managers and their regulators to confirm that the status and the credibility the profession seeks is merited. At the heart will be the determination of whether the actuarial profession in the U.S. is truly a profession, whether it is ready to supply disinterested counsel and service to its insurer clients and employers.

I obviously think it is, and I believe that will be confirmed! As a result, we will assume the mantle of professionalism and set forth the terms upon which we can execute the duties we will be asked to undertake. But, why wait? If we believe we are a profession, we need to assume the mantle of professionalism now.

In my mind this is the important link. The historic role of the actuary, at least during my professional lifetime, has not been based on provision of professional service. The rubrics of our work process; our relationships with clients and employers; our subservience to regulators; and our attitude of sidestepping the tough issues all find their roots in this nonprofessional status, which existed by default because the professional status was not there.

Now our professional platform exists. As we encourage our traditional life insurance constituents and their business associates to "Ask An Actuary," we do so because we wear the professional mantle. Otherwise, these are just words. In the U.S., we must take a role in setting our terms of service, and then perform.