

III. Ethics and Professionalism

Introduction

The actuarial profession substantially self-regulates its members' ethical and practice standards in the development and delivery of work products and actuarial opinions. It is particularly important, therefore, to have appropriate benchmarks that are measurable by both the profession and the publics served. The actuarial profession has made constant efforts in this respect through the Code of Professional Conduct and, as provided therein, by the development of qualification standards and Actuarial Standards of Practice. These primary sources of direction serve the actuarial profession as measurements of its members' professionalism and are the foundation for discussion in this section of the report.

Analysis

Code of Professional Conduct

In 2000, a joint committee of the five U.S. actuarial organizations proposed a single Code for the organizations to replace the outdated versions previously adopted in one form or another by the separate organizations. The goal at the time was to create uniform rules of conduct by which the profession and its publics could measure actuaries' performance in carrying out their responsibilities. This goal was met when all of the organizations adopted the same Code to become effective January 1, 2001.

While the Code has 14 Precepts and 23 Annotations, many agree that Precept 1 provides the most powerful guide to appropriate conduct, with the other Precepts and Annotations offering more detailed guidance.

Precept 1 states: "An Actuary shall act honestly, with integrity and competence, and in a manner to fulfill the profession's responsibility to the public and to uphold the reputation of the actuarial profession." It is important to the profession that the public understand and appreciate that the Code imposes the obligations of honesty, integrity, and competence on all actuaries. In a profession that projects future financial risks, our results are relevant based on our assumptions, data, and professional judgment. Because our work involves varying degrees of uncertainty, precision and accuracy of estimates are not to be considered as measures of professional conduct.

The Code is the primary tool currently employed in measuring professional responsibility and serves as the criterion for helping the Actuarial Board for Counseling and Discipline identify infractions of appropriate conduct.

In assessing how well this document has achieved its intended purpose of holding actuaries to a high level of ethical and professional behavior, the CRUSAP Task Force

examined survey results, personal interviews, and published literature. The following paragraphs summarize what we learned.

There is general acceptance of the Code as both a success story of cooperation among the five U.S. organizations and a provider of the intended tools and guidelines to which actuaries want to see their fellow professionals held.

There is a question in the minds of many who were surveyed and interviewed on how the Code is actually used in the discipline process and where the lines are drawn regarding specific incidents of Code violation. Concerns relate to the application of the discipline process and the lack of public notification of explicit facts relating to violations.

As discussed elsewhere in this report, the disciplinary process has been kept relatively confidential, with the members of the profession first becoming aware when notification of expulsion or other public discipline of a member is published by one of the actuarial organizations. Final decision on the form of discipline to be administered is left to the disciplined actuary's membership organization. Each organization may arrive at a different opinion regarding the severity of the violation and, as a result, impose a different form of discipline or none.

The imposition of different degrees of discipline by two or more organizations for the same infraction of the Code implies differing values and conflicting views of what constitutes appropriate conduct in the application of the Code. This creates another challenge to the profession's public image. Some interviewees and survey respondents believe that full public disclosure of the infractions would help to illustrate the differences between right and wrong practice and help educate actuaries in the proper applications of the Code in various situations.

Among the arguments made for full disclosure are that the Code and the ASOPs provide clear guidance about what constitutes appropriate practice. There were, however, a few comments to the contrary where respondents were concerned that divulging the details of discipline cases will serve to define boundaries of practice and encourage those who work to stretch these boundaries to the narrowest threshold of professional responsibility.

The opportunity for clarification of appropriate behavior through more detailed disclosure of Code infractions would appear to outweigh the potential loss of confidentiality in the process.

On another front, there is a long-standing concern in the profession that actuaries who are not members of any of the U.S.-based actuarial organizations fall outside the requirements of the Code and the ABCD's authority. This is true for a number of enrolled actuaries, as well as for some individuals conducting actuarial work, even though they may not be fully credentialed and eligible for membership in a U.S.-based actuarial organization. There should be continued effort to request that the Joint Board of Enrolled Actuaries adopt a form of a Code of Conduct that resembles the current Code to address this issue.

Actuarial Standards of Practice

Like the Code, ASOPs have been developed by volunteers from the actuarial profession. Adherence to the ASOPs is required by the Code and, therefore, binding on all members of the actuarial organizations when practicing in the United States. The current body of standards was initiated in the fall of 1985 with the establishment of the Interim Actuarial Standards Board and continued by the Actuarial Standards Board, created on July 1, 1988.

The development process for an ASOP begins with a draft standard written by an operating committee of the ASB, a task force, or a subcommittee reporting to one of the operating committees. Each area of actuarial practice has an ASB operating committee responsible for drafting and preparing Actuarial Standards of Practice for consideration by the ASB.

The current ASB operating committees are the Casualty Committee, the Health Committee, the Life Committee, the Pension Committee, and the General Committee (for standards that apply to more than one practice area). The committees (and their task forces) develop the initial draft language of a new or revised standard. The entire Actuarial Standards Board then reviews the draft standard and makes any appropriate changes to assure that the draft standard effectively communicates to its intended audience and reflects appropriate standards of practice. These changes are made in consultation with representatives of the appropriate operating committee. After the Actuarial Standards Board votes to adopt the draft standard, the draft is exposed to the profession and interested non-actuaries for comment.

Following the exposure period, the operating committee (or task force) considers each comment received and revises the draft standard as it deems appropriate. The Actuarial Standards Board reviews the revised draft and may make additional revisions to the draft. Depending upon the nature of the revisions, the ASB will either authorize a final standard or issue a second exposure draft. In general, if the changes are not expected to place more restrictions on practice (as compared to the exposure draft) and are not overly extensive, the ASB will adopt the standards. Otherwise, the ASB will adopt a second exposure draft. In some cases, a standard may go through three exposure processes before finally being adopted by the ASB. If the exposure process results in a lack of consensus, the draft standard may be dropped.

There are currently 42 ASOPs, many of which have been reformatted and revised to reflect changes in practice, clarifications, changes in regulations, and formatting revisions. The ASOPs have been designed to provide principles-based guidance on generally accepted practice.

The ASOPs complement Code precepts in providing guidance to actuaries in conducting specific tasks and in delineating their responsibility to various stakeholders for the results based on their actuarial practices and opinions.

Through the International Actuarial Association, there is an emerging practice of standards development dedicated to writing global standards that apply to cross-border practice. However, currently these standards are geared toward education and are not directed to address country-specific practices. This effort may well influence the way current ASOPs are applied and interpreted.

There are a number of areas of commentary pertaining to how the ASOPs meet the needs of the profession and the public, discussed below.

1. Generally accepted or best practice. Many comments in the survey responses and interviews address the quality of practices defined by ASOPs and specifically the difference between “generally accepted practices” and “best practices.” Is the ASB qualified to define best practice? Can best practice be appropriately defined for a sufficiently broad series of factual situations to achieve consistent results? The mere concept of best practice implies the superiority of one approach over all others, placing into question and potentially limiting alternative approaches. Also there may be a liability-related argument that the concept of best practice leaves all other levels of practice subject to legal risk.

However, the underlying objective of the ASB has been for standards to identify accepted practice and offer guidance to the practicing actuary. The ASOPs allow the profession to redefine, change, and incorporate best practices over time as they become understood and implemented as generally acceptable. At the same time, ASOPs allow for deviation from accepted practice when appropriate disclosures and explanations are made. It could be argued that as the public appreciates and rewards better practices, all practice will move to conform to what was previously best practice, and the appropriate ASOPs will be brought along to bring such practice into the realm of generally accepted.

This does not preclude principles-based standards meeting the objectives of representing consensus of practice and serving as a vehicle to raise the bar on the level of practice through the exposure draft process.

2. Moving the standards forward. As pointed out in a number of interviews, the actuarial profession is guided by many different sciences that provide the measurements and tools that we use to apply the principles of actuarial science. We apply actuarial principles to areas of law, accounting, finance, economics, and business administration. They’re also used in other sciences such as physics, medicine, and chemistry. As these uses change and grow, the actuarial profession’s generally accepted practices must keep up. ASOPs can take a minimum of 12 months from concept to final adoption. While this may seem a long gestation period to some, it is relatively consistent with other standard setting bodies such as the Financial Accounting Standards Board (FASB) and the Securities and Exchange Commission (SEC). As the profession moves into new areas, or as traditional areas evolve, this time lag should not cause the profession to lose relevance in the face of emerging techniques and a changing financial landscape. Therefore, there is a need for a well-defined public process to petition for the consideration of relevant changes in existing standards or creation of new standards.

As stated above, the traditional argument has been that deviation from any ASOP is permitted if appropriate disclosure is made and the actuary is prepared to defend his or her reasoning. Such deviations may be necessary because the standard codifies generally accepted practice at the time it was adopted. By the time specific actuarial work is performed, the practice may already be changing as a result of leading-edge thinking, regulatory changes, or requirements imposed by others outside the profession, such as the SEC or FASB. Congressional action can suddenly change a law, or court rulings can change its interpretation. There are expressions of concern that our standards can be so broadly written that regulators step in to define our practice and limit our professional judgment. The recently enacted Pension Protection Act of 2006 is presented as an example. While some may argue that this law came out of the actions of employer sponsors of defined benefit plans, the broad latitude of actuarial judgment has been significantly curtailed as a result. It is important that the actuarial profession establish the procedures and secure the authority to respond rapidly to changes to avoid further limitations on professional judgment.

There are also instances where long-standing and generally accepted practices do not embrace concepts that are part of some of these other sciences. As a critically important and current example, a growing number of actuaries are concerned about a disconnect between pension funding and liability measurements, the ASOPs that guide this practice, and the fundamental concepts of financial economics. This issue raises many concerns about the ability of the profession to move out in front of a dramatically different practice context. The question is whether we can achieve this, profession-wide, through an ASOP that represents, to some, a correction of current practice. This issue of ASOPs as a tool for change is one that needs to be explored because it has broader implications for actuarial work with clients, and for fending off efforts by other institutions to impose limitations on practice.

Is it the ASB's charge to monitor and address changes in generally accepted practice when there is a preponderance of evidence suggesting that practice has evolved? Or is the profession better served if the ASB is proactive in raising the bar beyond generally accepted practice, thus calling for a change in practice and imposing on the public served an increasingly higher standard? The challenge is to determine when that threshold has been reached. To the extent possible, there should be a defined mechanism that can be applied to call on the ASB to address such issues whether through the Academy Practice Councils or elsewhere. And, while to some extent this is one of the avenues the ASB has identified, the way to call for changes in ASOPs may not be apparent or understood by the profession at large.

Viewed in the proper perspective, most ASOPs do not limit the actuary's ability to practice in new ways or with new insights. There are those who feel deviation from a standard in order to raise the level of practice may cause difficulties for actuarial clients who may not want to have actuarial work that is unsupported by standards. However, if the exceptions to the ASOP become the rule, then the standards become marginalized. If the ASOPs are the definitive works by which the public at large measures the profession's core responsibilities, then the ASB may need to identify circumstances when

generally accepted practice is no longer appropriate and use the drafting process as a means to change practice. It is also important to recognize that while the ASB and the profession see ASOPs as guidance, the public may see them as “rules” and be suspicious when reports are issued that disclose deviations from the “rules.”

3. Conflict of interest. Even ignoring, for a moment, the body of standards guiding the ethical and professional conduct of actuaries, the actuary faces the same potential conflicts of interest as anyone working in the business world. Whether actuaries consult for many businesses or for one, or work in academia, they serve more than one public. Whether actuaries’ clients are the companies that pay their fees or employers who sign their paychecks, clients’ goals and objectives may diverge from the findings produced by objective, fundamental actuarial analysis.

It is not difficult to envision situations in which even actuaries with high regard for the Code and ASOPs find themselves advocating for their clients. By succumbing to pressure to meet the client’s needs instead of providing an objective work product, they could be judged to have compromised their objectivity.

It can be argued that, in certain respects, some of the ASOPs have helped support these impressions if “generally accepted” practice is a function of the specific work product that is subject to the influence of clients’ needs. However, based on the CRUSAP surveys and interviews, it would appear that the profession has done a good job of balancing these pressures. Some argue a more prescriptive set of standards would support the profession by providing a set of rules for reporting. However, a greater number place substantial reliance on “actuarial judgment” in providing real value to actuaries’ work products, as long as the actuaries can maintain objectivity and independence in the face of advocacy pressure – or, as an alternative, fully disclose the advocacy responsibility and areas of their work product that reflect their position.

It is, however, unclear how actuaries can resolve conflicts with their clients. As long as a client can threaten to find another actuary to provide actuarial services, the implied leverage might well have an effect on the actuary’s work product. And, because of its relatively small size, the actuarial profession lacks the financial resources to either implement independent procedures or support a paid professional standards board such as the FASB, a suggestion posed by a number of survey respondents (who may not understand that the FASB is often called upon by the SEC to develop reporting standards for publicly traded corporations).

4. Principles-based vs. rules-based standards. Many CRUSAP survey responses reflect a desire, articulated as well by respondents to the Academy’s 2005 Professionalism Standards Summary Survey, for “greater practical guidance on matters involving professional ethics and judgment.” Some CRUSAP survey respondents feel that the ASOPs should provide such practical guidance, while others want them to remain principles-based and allow for the application of greater actuarial judgment. There is a fundamental concern that rules-based standards remove judgment and put professionalism at risk in the process.

The objective of a rules-based standard is to remove the potential influence of clients from the actuarial work product. The issue of developing rules in applying actuarial processes that would take precedence over professional judgment threatens to marginalize the value of our work product. For many actuaries, it is the concept of actuarial judgment – reflecting years of practice and experience and an understanding of multiple financial and statistical trends – that represents the value added by actuaries over other risk analysis professionals.

Actuaries sell objectivity in the application of experienced judgment in such matters as assumptions and modeling of likely future events. Some actuaries are concerned that if objective judgment is exchanged for standards that set procedures over principles, their practice will be compromised, and the actuarial work product will become commoditized. However, the way the actuarial profession has used its judgment has influenced others to impose rules that, in effect, force our practice into a rules-based process through reporting standards and tax compliance laws. Does that mean objectivity and actuarial judgment are synonymous with the concept of actuarial professionalism? For our judgment to be valued, the public's trust in our ethics and professionalism must be high, as well. It may require that some ASOPs, even though principles-based, limit the extent to which judgment can be applied in order to avoid a public call for more specific practice-based rules.

5. Public understanding of the profession. Why is the public's understanding of the actuarial work product important to a review of the profession's ethics and professionalism? When actuarial work is challenged by the public, the profession seems to be judged unfairly because of unrealistic expectations. There is little understanding of the fundamental uncertainty of actuarial work and objectives in the determination of a best estimate valuation process.

This is an emerging issue because the public tends to equate actuarial uncertainty with incompetence, which adversely affects our reputation when this assessment is disseminated through various media and the courts. The public perceives the actuarial work product as the correct value rather than the best estimate of a range of probable values. While actuarial work products are based on expectations of future financial outcomes, the public often mistakenly compares our results with financial results that reflect past performance and spot valuations.

Only those who understand the concept of actuarial assumptions and results based on probabilities accept actuarial findings in terms of best estimates and understand that future events can cause great variance and volatility in the same measurements over time. Hence, the profession's ethics and professionalism will be better appreciated by the public if the public has a better understanding of the nature of actuarial work.

6. Measuring professionalism. The Academy's 2005 Professionalism Standards Survey found that only 28 percent of responding actuaries had read the qualification standards. And this response was from the same fraction of the profession that answered the survey, which might imply a much lower percentage among all actuaries if we make an inference

that those who answer professional surveys are more engaged in the issues of the profession than those who don't.

While there are high percentages of those in the CRUSAP survey who are familiar with the Code, qualification standards, and the Actuarial Standards of Practice, is that enough? Are the applications of the ASOPs a measure of our dedication to professionalism?

Some of our survey results raised the question of whether professionalism can be learned in the lecture hall or meeting room, or through the shock of seeing case studies that sound too much like one's own practices. The profession needs to develop an initiative that will keep the membership continually aware of their responsibility to read, understand, and apply ASOPs in daily practice.

7. External viewpoints. There has been some discussion, particularly in the individual interviews, about the need for external input into actuarial standards. This seems to reflect the same general concerns about a profession that is essentially self-regulated. It may also be part of the debate suggested above in areas where we are expected to have some degree of expertise, such as in the field of financial economics, but not sufficient impetus to incorporate external responses into our ASOPs. In part, such input and direction might be effectuated through an oversight board. However, there is general concern that our practice is hard enough to understand by other professions and that our standards of practice should be defined by actuaries.

There may, however, be a valuable role to be played, in the eyes of both the profession and the public, by regular periodic review of the ASOPs, the ASB and the standard setting process that would include external user representation to obtain some arm's-length views of our continuing ability to regulate our practice.

Conclusions

It is important for the profession that the Code be generally accepted and considered an effective statement of its values and criteria in the conduct of actuarial business. Likewise, the ASOPs represent to the profession the primary way to measure specific practice.

Through the Code, the ASOPs, practice notes, issue briefs, and related literature, the profession has been effective in maintaining high grades in the areas of ethics and professionalism among those who work with actuaries. As the public is increasingly exposed to what actuaries do, however, the relatively low degree of understanding of the profession and its work product could jeopardize this success. The profession needs to develop strong new initiatives to broaden the public view of our work and enhance the ethical and professional standing of the actuary in the world of business and in society.

We conclude that the profession should look forward in the following areas:

- Exploring ways to support changes in actuarial practice. Actuarial professionalism is challenged both by the profession's ability to remain current with academic thinking and by its willingness to accept concepts and theories relevant to actuarial science and emerging practice that are developed outside the profession. This may call for change in the way ASOPs are developed.
- Providing more guidance on conflicts of interest that actuaries can present as the basis of countering agency pressures from their clients and in support of Precept 1 of the Code. This is an opportunity to explore ways in which actuaries can report on bad business practice without subjecting themselves to increased potential for litigation.
- Engaging the profession to continue to advocate to the Joint Board of Enrolled Actuaries that it adopt a Code of Conduct to bring all actuaries under a professional conduct requirement.
- Developing and communicating a process whereby actuaries can identify to the ASB areas where new ASOPs are needed and where ASOPs should be revised.
- Defining and implementing a periodic external review of the activities of the ASB and the ASOPs, with non-actuary users of actuarial work products as part of the reviewing body.