

**THE ETHICAL DEVELOPMENT
OF ACTUARIES**

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BIOGRAPHY:

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ABSTRACT:

While there have been a number of actions taken in the last several years to establish professional standards and to provide some form of discipline regarding these matters, there remains much more to do in the development of actuaries who act ethically. Our focus will be on actuaries and actuarial managers though much of what we discuss can be applied to personal ethical issues and to ethical issues arising in other professions. We will discuss some underlying ethical concepts and pressures on actuaries not to act ethically (along with some examples). Next, we will outline a procedure for ethical decision making and provide an actual example of the procedure in use. Finally, we will outline some methods for use by actuarial managers and supervisors to help promote and teach ethics to actuarial students and others.

INTRODUCTION

While there have been a number of actions taken in the last several years to establish professional standards and to provide some form of discipline regarding these matters, there is much more to do in the development of actuaries who act ethically. The predominant responsibility for this lies with actuarial managers and supervisors. They need to develop actuaries who will not merely follow the rules. The actuary needs to be strongly predisposed towards doing the right thing and the only way that we feel that that can be handled is by promoting and developing certain thought processes and translating those into actions. This is because one needs to be able to make choices over time that may not fit neatly into the rules. Our focus will be on actuaries and actuarial managers though much of what we discuss can be applied to personal ethical issues and to ethical issues arising in other professions. We will define what professional ethics means and discuss some underlying ethical concepts and pressures on actuaries not to act ethically (along with some examples). Next, we will outline a procedure for ethical decision making and provide an actual example of the procedure in use. Finally, we will outline some methods for use by actuarial managers and supervisors to help promote and teach ethics to actuarial students and others.

DEFINITION OF PROFESSIONAL ETHICS

There are many areas of discussion for which it is appropriate and even necessary to consider actuaries apart from others. However, for the purpose of defining professional ethics, it may be beneficial to rely on a

definition broad enough to apply not only to actuaries, but to others as well. Using such a broad definition, one can then specifically consider actuaries and professional ethics.

Generally, one may define ethics as the discipline dealing with what is good and bad and with moral duty and obligation. From this definition, one can formulate a definition of professional ethics as the principles of conduct governing both a professional body and individual members of the professional body. What should these principles be?

Many individuals have defined principles of ethical behavior. Some have developed a clear and simple set of principles, while others have postulated very complicated ones. After reviewing several sets of these principles, it becomes apparent that all have a common theme; that is, ethical decision-making consists of doing the right thing. Let us proceed by discussing what is meant by the right thing.

Most of us have an inherent idea of what is meant by doing the right thing. A usable definition might be that doing the right thing consists of making choices consistent with basic, fundamental values. By evaluating how these basic values relate to an issue being considered, the ethical implications of an action often become clearer. While an individual is no doubt best able to express his or her own set of basic values, an example of such a set might be:¹

¹ The idea of making choices in this manner and the following list are based on items discussed by Mary E. Guy (in Ethical Decision Making in Everyday Work Situations, Quorum Books, New York, 1990, pp. 3-23).

1. Respect Others

Individuals have intrinsic worth which must be respected. Treat people as ends in themselves, not means to an end. Treat others courteously and with dignity and compassion.

2. Be Honest

Tell the truth. Do not distort or amplify the truth. Do not deceive yourself or others.

3. Be Responsible

One must accept the consequences of one's actions and the responsibility for one's decisions.

4. Keep Promises

Be someone on whom others can depend. A corollary to this may be Don't Overpromise.

5. Pursue Excellence within Prescribed Guidelines

Be diligent, hard-working and committed, but stay within the rules.

6. Be Loyal

Loyalty to oneself, organization and customers is critical.

7. Be Fair

Do not play favorites. Treat people and organizations equitably.

8. Avoid Conflicts of Interest

One should strive to maintain one's independence.

9. Respect Societal Values

Avoid actions generally regarded as inappropriate.

With these ideas in mind, let us define ethical behavior as being that behavior that selects that option from all available options which best matches one's basic values. With such a definition, it is apparent that there is not always a clear-cut, correct course of action. The point to be made, however, is that in making decisions, one needs to be aware that there may be many and varied considerations. With such a definition of professional ethics, let us move forward to look at the various pressures under which decisions may need to be made, along with some examples.

PRESSURES ON ACTUARIES

For purposes of this discussion, let us divide the ethical pressures under which decisions may need to be made into four categories:²

1. Ethical Use of Authority.
2. Loyalty to Organization versus Adherence to Personal Conviction.
3. Duty Owed to People versus Duty Owed to Corporate Goal.
4. Difference between Honesty and Deception.

² Adapted from Buckingham, Clay T., "Ethics and the Senior Officer: Institutional Tensions," Parameters, Vol. XV, No. 3, U.S. Army War College, Carlisle Barracks, Pennsylvania, Autumn 1985, pp. 23-32.

While there is some overlap between these categories, a grouping such as this will provide a reasonable means to analyze most (and potentially all) of the various ethical pressures under which decisions may need to be made.

Ethical Use of Authority

An actuary, particularly a senior-level one, very often may function in a position within an enterprise such that he or she wields a great deal of authority. Particularly at a senior level, an individual's decisions may be less scrutinized than those of someone in a less senior position. Thus, an individual needs to be careful not to overextend his or her authority beyond its limits. On the other hand, a person must also use the authority he or she has been granted to carry out his or her delegated responsibilities. To summarize, a person should try to use the authority vested in him or her to discharge assigned responsibilities in as complete a manner as possible while at the same time not exceeding the level of authority granted.

Examples of pressures falling into this area would include:

An actuarial supervisor takes on work beyond the capacity of staff to perform. When confronted by staff with this situation, the supervisor responds, "Well, we need to do whatever it takes to get the job done." Responses such as this can leave staff wondering what is meant. Staff may develop the outlook that corners should be cut, principles and guidelines violated, or laws broken if that's what it takes to "get the job done."

As the actuary in charge of loss reserves, you have the responsibility to allocate reserves within your company to product line. Early in the process you begin receiving hints from some of the product line managers that their incentive compensation is based on the performance of their line, and that it would be nice if you could see your way to allocate relatively little loss reserves to their line. Should the actuary in this position ignore such comments, report them to someone else within the company, or consider some other action?

Loyalty to Organization versus Adherence to Personal Conviction

Situations falling within this category include those in which an employee feels that if he or she were running the company, he or she would never choose the course of action that has been selected. Nonetheless, it is that individual's assignment to implement the decision. Specific examples include:

You have been asked to issue an actuarial statement of opinion regarding the reserves of an insurance company. The insurance company is a subsidiary of a multinational corporation whose financial solidity is unquestioned. After completing your analysis, you feel reserves are 15% less than what they should be. The amount of money is incidental to the parent, but due to timing issues, having to go back and restate the reserves of the insurance company would be difficult. You are asked if the additional reserves are really necessary, given the financial solidity of the parent and the amount of difficulty and expense making the change would necessitate. How should you respond?

You are the actuary involved in pricing a loss-rated account. The company's corporate guidelines specify a target return on equity. Pressure is brought to bear on you to "keep the price reasonable" since this is a key account for the company and the word is that other companies are also bidding on this account. After pricing the account to meet company guidelines, you are told by the sales manager that the price you propose is way too high and it guarantees the company will lose the account. The sales manager goes on to add that if this account is lost, it's obvious who is responsible for the loss, and furthermore, the CEO of the company (a former sales manager) will be on the warpath. What should you do?

You have been instructed to research a particular problem at your company and implement a solution. The one solution that is obviously the best would require the company to exceed its expense goals by a very large amount. All other solutions are within budget, but would only succeed in covering up the problem for a short time. What should you do?

Your supervisor asks you to perform a task which is illegal. You point this out to the supervisor, but the only response you receive is, "Don't worry about that, no one will ever find out." What should you do?

People versus Mission

Situations that fall within this category generally involve the loyalty one

might feel to individuals (subordinates, coworkers) and the loyalty one feels toward the mission of the employer. Specific examples include:

You have been told a project needs to be done in three days. This goal is attainable only if the entire staff works very late. During the past six months the staff has had to work late more often than not, and you sense a serious decline in morale. Finally, the actuarial students have actuarial exams the following week, and you know that they need to study as much as possible to have a chance to pass their exam. How should you handle this situation?

You are working on an efficiency study for your company. You have been told that this study is strictly confidential. It becomes obvious early on that a department in which a close friend works will be eliminated. Your friend recently let you know that since he has now been with the firm for five years, he feels more secure and is going to buy a new house and car. What would you do?

You are being asked to work thirty hours of overtime during the next two weeks. Your actuarial exam is in two weeks. If you fail, your company's policies require that you be removed from the actuarial program. What should you do?

Honesty and Deception

Most of us can recall situations when we may have been asked broad, general questions by someone who might be inquiring in a general way as to how things are going. You might be aware of a problem, but know that you are

the only one who knows anything about it. You are faced with deciding between bringing up a situation that might reflect poorly on you, or not bringing it up and living with the consequences. Some examples of this situation include:

You are working on a project and it becomes apparent that you will not have enough time to thoroughly investigate all issues before the project needs to be done. Earlier in the project, you gave every indication you would be able to complete the project on time. Now you are faced with completing the project without thoroughly investigating all areas, or asking for more time. What would you do?

You are asked to comment on an insurance company's loss reserves. Your opinion is that loss reserves are adequate. However, you are also aware that a large portion of the company's assets are in jeopardy and will soon be in default, erasing most if not all of the surplus. What should you do?

ETHICAL DECISION MAKING

Having discussed a number of ethical situations that actuaries may face, we will turn to a procedure that we recommend for dealing with ethical questions. When faced with a situation posing an ethical question, one of two things will occur: the issues and their resolution will be very clear or the issues will not be clear and it will be necessary to resolve the issues. Another situation that arises is where the issues are clear but the course of action is not clear. These are situations that call for an organized

reasoning process. This process is a four-step process:³

1. Interpret the situation. What is the ethical question or dilemma?
2. Analyze all the factors and forces that relate to the question at hand.
3. Choose the course of action that you believe will best solve the dilemma.
4. Implement the course of action you have chosen.

The first step is critical. It is the step that initiates the process and is the basis for the rest. It is very critical to identify the ethical dilemma. It should not occur often, but it is possible that the other steps will trigger a reassessment. Is the issue one of violating a professional standard? Is the issue one of how something is going to impact a customer? Are you being asked to relax your professional standards to a point where you are not comfortable? Are you being asked to do something that either violates or helps others violate a law? Are you in a situation where no matter what you do you will feel that you have violated some principle or value that is important to you? Whatever the situation is, try to identify correctly what the real ethical issues are so that you can best address the next step.

³ The process described here is adapted from a process described in U.S. Army Field Manual 22-100, Military Leadership, Government Printing Office, Washington, October 1983, pp. 97-100.

The second step involves the analysis of factors and forces that relate to the situation. Factors that will influence the decision include:

1. The possible and likely outcomes of different choices.
2. The environment in which the question has arisen. Is the situation being discussed openly or are others trying to hide the discussion from the view of others? While not universally true, the more openly issues are addressed, the less likely it is that poor ethical decisions are made.
3. Your position in the situation. Do you have a great deal of control or very little control?
4. Is the situation a personal or business situation?

Forces that will influence the decision include:

1. Legal standards. These are the statutory and regulatory standards under which we operate.
2. Professional standards. These are the standards promulgated by the Casualty Actuarial Society and the American Academy of Actuaries through the Actuarial Standards Board.
3. Society's values. These are the values that society establishes such as respect for individual rights.
4. Company values. Companies vary in this. Some companies place a value on certain items that do not neatly fit elsewhere. These can be both positive and negative values and may or may not be publicly stated.

5. Institutional pressures. These are elements of company policies, procedures, and other aspects that influence the ethical reasoning and behavior of individuals.
6. Individual values. These are the values held by individuals in the situation.

The analysis of these factors and forces is important in attempting to clarify what the desired end-result is. In this step, it may be necessary to consult others. The more complicated the situation, the more advisable this becomes. While it may be difficult to determine who to approach and how to address the situation, it can pay great dividends in clarifying issues, raising possible alternatives, and crystallizing resolve.

After completing the above analysis, the next step is to choose the course of action that you believe will best meet the test of time. It ought to be a course of action that you can explain openly and without hesitation. This may not be easy, especially in situations where different values collide and you find that the choice you make is the lesser of two evils.

After identifying the ethical dilemma, analyzing the factors and forces related to the dilemma, and choosing the course of action, the final step is that of implementing the course of action. This last step can be the most difficult since this is the step at which consequences occur.

We have outlined a process designed to aid individuals in making the best ethical choices possible. It is neither boilerplate nor foolproof. Even after following this process, the wrong decision can be made. Even if the

right decision is made, it does not mean that the decision is without cost or consequence. This is what makes ethical decision making difficult. The following example supports this.

AN EXAMPLE

This is an example of the process in action. It is not hypothetical. The names of individuals have been changed and the names of the states have not been provided. The basic situation began when a company sales representative and an underwriter approached actuary, John Smith, with a sales opportunity. A group of accounts in State X wanted to be group rated. John had had a similar issue (though not involving group rating as in this case) raised by State Y regarding its fictitious grouping law. This had occurred in a rate filing where the general sense of those involved from the company was that the state had possibly stretched a point, but it had raised awareness of the existence of these laws. John looked at the statutes for State X and found that it had a very clear-cut fictitious grouping law that left no real question in his mind that group rating this group of accounts would violate the law. At this point he communicated that he felt there was a problem and that the company should seek other alternatives to trying to write this block of business. One of the company's officers asked if the legal department had opined on this. Since they had not, they were asked to review and provide an opinion. The opinion provided indicated that there might be a way to justify using group rating in this situation. John was again asked to develop rates for the group. Because he was uncomfortable with the legal analysis, he asked whether it would not be prudent to approach the Insurance Department with the facts and seek at least tacit

approval for group rating the accounts. The response was that it should not be necessary since the incumbent carrier was already doing it. John countered by saying that if this were indeed the case that it should not be a problem to ask the state directly. Again, the response was that the state should not be approached. This time it was with the idea that if the state said no that the accounts would be mad at the company for ruining a good deal for them. At that point, John felt that he had a basic question to resolve: Is it illegal to group rate these accounts?

His next step was to analyze what the issues were. No one seemed to support the idea of dealing openly with the Insurance Department. This called into question how firmly others believed this was legal. His ability to control the situation seemed to be in question since others were pressing ahead despite the questions raised. The issue of professional standards was tied strictly to the legal issue since the pricing would not violate any exclusively actuarial standards. The company wanted to write this block of business. These accounts were very much the type of accounts that the company liked to attract, they represented a substantial amount of premium, and ignoring the legal question inured to the benefit of the customers. The legal department had offered an escape from this by providing what John felt was a weakly worded opinion but one on which he could say that he had relied (after all, John was not an attorney). Finally, John's boss and his boss's boss (both company officers, one of whom is an actuary) wanted to move forward with this following the legal opinion.

John's next step was to look at possible alternative actions. These included going along with the group rating, contacting the Insurance

Department on his own and seeking an opinion, refusing to do the work, or hoping that he would be somehow bypassed (due to knowledge of his reluctance) and one of the other actuaries that worked for John would be asked directly to work on it. At the time, the normal workflow procedure would have been for John not to be directly involved.

John weighed his options. He sought advice from the legal department concerning his ideas about contacting the Insurance Department. He sought advice from two other individuals whom he respected, and then he pondered. Going along with the group rating and just hoping that it was legal was out of the question for John. The two major problems with this were that if it were illegal he would have knowingly helped the company violate a statute and if this were to be discovered, he worried about the impact on his professional standing as an actuary. Going to the Insurance Department seemed attractive but it would mean going against directives not to do that. Refusing to do the work seemed to have undesirable consequences. There was at least the real possibility that he could be fired. There was also the possibility that he could be made out to be a legalistic something-or-other and that most anyone else would have done this without any real question. Hoping that he would be bypassed seemed the coward's way out, and since he was responsible for the work of the actuaries that reported to him, it seemed to be an academic exercise in avoidance. Finally, he came to the conclusion that he needed to refuse the project.

In order to implement this course of action, John determined that he first needed to block the possibility that his people would be asked to do the pricing without his immediate knowledge. Second, he sensed that he needed

to place his refusal in writing so that there would be no questions why he refused and so that others would have a harder time painting a different picture of the situation. In doing this, he combined the two. He wrote (and held) a memorandum to his supervisor stating that he had discussed this with his people and directed them not to work on the group rating without John's direct approval. He stated that he had not gone out of his way in interpreting the law - he felt that it was clear (one of the most clearly worded fictitious grouping laws he had seen) and that without discussion with the Insurance Department, he could not in good conscience do the work. He then held the discussion with his people and reviewed his reasons for arriving at his conclusion and the reasons for his directive that they not work on it without his direct authorization.

The story almost ends here. In questioning the group rating, John caused the quotation process to be delayed to a point where the broker and the underwriting department determined that it was probably too late to put together a quote for delivery in time for the customers. While this was not an intended result, it did make it so that John did not actually have to refuse to do the work. As a footnote to the story, a similar situation in State Z was brought to the company sometime later. For some reason, the sales representative, the underwriter, and the agent involved visited that state's Insurance Department. While State Z's fictitious grouping law was not as clear-cut as State X's, the Insurance Department concluded that while a strong case could be made for it benefiting a group of insureds within State Z, it was clearly illegal.

METHODS FOR MANAGERS AND SUPERVISORS

Besides making a difficult ethical choice in the above example, John Smith did certain things that we would propose should be done by managers and supervisors in developing ethical actuaries. He acted as a role model and he discussed an ethical situation and explained his thought process and actions to his subordinates.

Actions speak louder than words. In the case of ethical behavior, actions shout while words are barely heard. A very strong case can be made that ethical behavior is learned more by example than by any other means. In trying to develop ethical actuaries, the actuarial manager must teach that ethical behavior is important, and must above all, act ethically. The strong sense that an individual receives from seeing a strong ethical example set cannot be underestimated. To a large extent, this example, as seen by others, is a matter of perception. This leads to the necessary conclusion that the manager needs to check how the manager's actions are perceived. A reason that this is so is that since many situations are not clear, the manager's reasoning may not be clear or it may be disagreed with. Thus it may be necessary in those cases to explain the reasoning.

Even if it is not necessary to explain in a particular instance, it is a useful teaching tool. It provides actual examples to trigger people's thinking on ethical matters and helps solidify the idea that ethical behavior is important. It also helps to provide a stronger base on which the actuaries that work for you can build for the times when they have to make ethical decisions.

Both acting as a role model and explaining one's thought processes and actions help promote a general environment of ethical behavior. The impact of acting as a good role model and the personal contact involved in explaining the reasons for decisions and actions that involve ethical issues help raise the sensitivity of others to ethical issues. Both of these actions require that the manager be sensitive to ethical issues, candid with others, strong in one's convictions, and comfortable with oneself. Thus, it is not as easy as it sounds to actually be the role model that one ought to be nor to be able to explain the reasons for decisions and actions.

CONCLUSION

While the actuarial profession has been developing standards and rules for actuaries to follow, it is necessary that actuaries look beyond the rules and focus on trying their best to do the right thing. We have not provided any magical solutions to developing ethical actuaries. We have tried to provide a solid base on which discussions can take place on both what it means to be an ethical actuary and how managers and supervisors can help develop ethical actuaries.

