AMERICAN ACADEMY OF ACTUARIES

Council on Professionalism

DISCLOSURE UNDER THE CODE OF PROFESSIONAL CONDUCT

Concepts on Professionalism

Discussion Paper

Prepared by

Joint Committee on the Code of Professional Conduct

PROFESSIONALISM SERIES
2005 • NO. 5

TABLE OF CONTENTS

PREFACE

This discussion paper, developed by the Joint Committee on the Code of Professional Conduct, addresses questions involving the application of and considerations that can be taken into account in disclosures involving the Code of Professional Conduct (the Code) in certain actuarial practice situations. It also intends to inform other interested parties on the actuarial profession's approach to disclosure and professionalism. This paper is not promulgated by the Actuarial Standards Board. It is not binding upon any actuary, nor is it intended to limit interpretation or obligation to practice within the concepts presented.

In fulfilling their various professional responsibilities with respect to disclosure, actuaries should be guided by the Code itself. To the extent any conflict exists or could be implied between this paper and the Code, the Code prevails.

Members of the U.S. actuarial organizations are encouraged to share comments on this paper with the Joint Committee on the Code of Professional Conduct by submitting them to **paper@actuary.org**.

APRIL 2004

The Joint Committee on the Code of Professional Conduct presents these ideas with the expectation that they will be both useful and thought-provoking and will enhance actuaries' consideration of their responsibilities with respect to disclosure. Ultimately, it is the Code of Professional Conduct that governs the responsibilities of actuaries in this area. However, the ideas and suggestions offered in this paper may assist actuaries in applying the Code of Professional Conduct to individual situations. The committee believes that expanded discussion of the concepts and suggestions offered in this paper will benefit the profession.

JOINT COMMITTEE ON THE CODE OF PROFESSIONAL CONDUCT

Kenneth A. Kent, Chairperson

Paul Braithwaite	Sam Gutterman
Morris W. Chambers	Luis Huerta
Ruth F. Frew	

BACKGROUND

The stated purpose of the Code of Professional Conduct is to require actuaries to "adhere to the high standards of conduct, practice and qualifications of the actuarial profession ...".[1] The Code addresses many aspects of actuaries' professional activities, including disclosure of various types of information to various audiences.

This paper is organized consistent with the structure of the Code, and focuses specifically on the Precepts of the Code that explicitly address disclosure. The committee is not advocating any mandatory practices beyond those required by the Code, Actuarial Standards of Practice (ASOPs) and the Qualification Standards for Prescribed Statements of Actuarial Opinion (Qualification Standards). It was prepared to promote discussion and broader understanding of the practical application of the Code in situations involving actuarial practice. It is not an interpretation of the Code, nor should it be read as an authoritative statement of the intent underlying the Code. Nevertheless, the committee believes that actuaries working in all types and areas of professional practice can benefit from reading and considering the concepts and suggestions contained in this paper.

By sharing the thoughts of the members of the committee, all of whom are experienced actuaries, the committee encourages each actuary to give appropriate consideration to the concepts and suggestions contained in this paper. Ultimately, however, each actuary must decide how to fulfill his or her professional responsibilities.

[1] The Academy's Code is identical to the Codes of Professional Conduct of the American Society of Pension Professionals and Actuaries, the Casualty Actuarial Society, the Conference of Consulting Actuaries, and the Society of Actuaries, and is substantially similar in most respects to the Rules of Professional Conduct of the Canadian Institute of Actuaries.

PROFESSIONAL INTEGRITY (PRECEPT 1)

Precept 1 of the Code requires actuaries to "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." Actuaries may disagree on the exact nature and scope of disclosure required in a particular setting to satisfy Precept 1 in specific situations.

One issue that sometimes arises under Precept 1 is whether and to what extent the precept imposes upon individual actuaries a duty to the general public. In its discussion paper titled, "The Actuary's Relationships with Users of a Work Product," the American Academy of Actuaries' Committee on Professional Responsibility addressed this issue. That discussion paper states that Precept 1

> ... does not mean that an individual actuary is personally responsible to each member of the general public regardless of whether the actuary has a professional relationship to or has sought to influence that person. Rather, it means that actuaries who comply with the Code and meet their appropriate professional responsibilities to principals and other users of the actuary's work product indirectly benefit the general public as well.

The Committee on Professional Responsibility's discussion paper is not and does not purport to be authoritative. However, it offers a useful perspective on how individual actuaries comply with Precept 1 that may help clarify the actuary's disclosure responsibilities to the extent that those responsibilities implicate the interests of the general public. Other precepts of the Code, discussed below, are more specific than Precept 1 in addressing disclosure in particular situations. Consequently, compliance with those disclosure provisions could be thought to be sufficient to meet actuaries' disclosure responsibilities under Precept 1 whether with respect to their principals (*i.e.*, clients or employers), other intended users of the actuary's work (e.g., regulators), or to the public as a whole. Disclosure alone, however, may not be sufficient to comply with the actuary's responsibility under the Code to avoid intentionally producing results that mislead the public.

Annotation 1-2 of Precept 1 offers additional guidance in this area, requiring that an actuary should not provide professional services to a principal if the actuary has reason to believe that the services will be used to violate or evade the law or in a manner that would be detrimental to the reputation of the actuarial profession. Normally, such "reason to believe" exists where the actuary has actual knowledge that the results of these services will be misused. Disclosure consistent with the specific requirements of the Code discussed below may help the actuary avoid such misuse of the actuary's work, as it may put readers on notice of who the intended user(s) of the work are, limitations on permissible use, or other relevant information. If, however, the actuary has a clear understanding of how the result may be misused, the Code may require the actuary to take steps in addition to disclosure to prevent such misuse.

QUALIFICATION STANDARDS (PRECEPT 2)

Precept 2 of the Code requires actuaries to perform professional services only when they are qualified to do so based on basic and continuing education and experience, and only when they satisfy applicable qualification standards. In the United States, the applicable qualification standards are those promulgated by the Academy through its Committee on Qualifications.

The Academy's *Qualification Standards for Prescribed Statements of Actuarial Opinion* ("Qualification Standards") call for a Prescribed Statement of Actuarial Opinion ("PSAO") issued by an actuary to include "an appropriate acknowledgment of qualification." The Qualification Standards include a sample of such an acknowledgment:

> I, [name], am [position] for [company]. I am a member of the American Academy of Actuaries (or other organization) and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

In making this certification, the actuary may wish to highlight that the certification does not suggest that membership alone is sufficient to qualify the actuary to render the opinion. Instead, the statement merely confirms that the actuary is a member of the Academy and states the actuary's belief that he or she has met the appropriate Qualification Standard.

The Qualification Standards also provide that "[a] qualification acknowledgment is not required on pre-formatted forms, e.g., Schedule B (Form 5500)." Nonetheless, some actuaries choose to include an acknowledgment of qualification in a letter or other communication that accompanies such a pre-formatted form if, in the actuary's professional judgment, such an acknowledgment would be beneficial.

As of the date this paper was being prepared, proposed revisions to the Academy's Qualification Standards were being exposed to the membership for comment. Consequently, it may be that the Qualification Standards, if amended, will call for a different disclosure than that referenced in the current Qualification Standards.

STANDARDS OF PRACTICE (PRECEPT 3)

The Code requires actuaries to ensure that professional services performed by or under the direction of the actuary satisfy applicable standards of practice. The ASOPs promulgated by the Actuarial Standards Board are the applicable standards for practice in the United States.

There are more than forty ASOPs, each of which contains its own disclosure requirements. Compliance with Precept 3 normally includes making the disclosures called for by the ASOPs that apply to a particular professional assignment performed by the actuary. When commencing an assignment, the actuary would normally be prudent to determine which ASOPs may apply. The Applicability Guidelines published by the Academy's Council on Professionalism can assist the actuary in making this determination.

All of the ASOPs contain a "deviation clause" that addresses situations where the actuary, as a matter of professional judgment, determines that it is appropriate to deviate from the specific guidance offered in the ASOPs. Where the actuary deviates from the provisions of an ASOP, the actuary is called upon to disclose the deviation and its effects in an appropriate actuarial communication. Appropriate compliance with the deviation clause satisfies the requirements of the ASOP with respect to the disclosure of the deviation.[2]

An example of an ASOP that addresses disclosure in particular detail is *Actuarial Communications* ("ASOP No. 41"). ASOP No. 41 applies whenever the actuary communicates professional findings, opinions or recommendations to a principal, whether the communication is oral or in writing. The ASOP applies to the full course of communications between an actuary and a principal, so that, for example, an individual e-mail communication need not meet all of the requirements of the standard so long as they are met overall. ASOP No. 41 is also a general standard and, on its face, does not apply to the extent that it conflicts with more specific guidance on communication, documentation and disclosure included in other standards. However, given the broad applicability of ASOP No. 41, the actuary would generally be prudent to meet its requirements whenever providing professional services to a principal.

---

[2] The Introduction to the Actuarial Practice provides additional information on the deviation clauses in the Actuarial Standards of Practice.

COMMUNICATIONS AND DISCLOSURE (PRECEPTS 4-6)

Precepts 4-6 of the Code address several aspects of communication and disclosure between the actuary and the principal with regard to a work product. Precept 4 requires an actuary who issues an actuarial communication to take appropriate steps to ensure that the communication is clear and appropriate to the circumstances and its intended audience and satisfies applicable ASOPs. This does not imply that the actuary must ensure that the intended audience or any other user actually *understands* the actuary's communication, as the actuary is not held responsible under the Code for the level of care that the intended audience takes in receiving and considering the actuary's communication. Rather, Precept 4 simply calls upon the actuary to consider what reasonable steps might be taken to provide the intended audience (not third parties who might receive the communication without the actuary's knowledge or consent) with a clear and appropriate communication, and to take those steps as needed. Therefore, an actuary who makes a good faith effort to satisfy Precept 4 and whose communication contains information that the actuary, as a matter of professional judgment, considers sufficient, would generally be considered to have satisfied Precept 4.

Disclosure can be particularly helpful in satisfying the requirements of Precept 4, because it offers the actuary the opportunity to convey to the intended audience information concerning the scope and intended use of the communication, any limitations on scope and use, any limitations that the actuary places on the substance of the communication (for example, qualification of an opinion concerning the adequacy of a specified reserve) or other information that the actuary believes will make the communication clear and appropriate to the circumstances.

The annotations to Precept 4 address two specific requirements. Annotation 4-1 calls for the actuary to ensure that an actuarial communication "clearly identifies the actuary as being responsible for it." Many actuaries believe that signing the communication, or a covering letter or other document to accompany a communication in a pre-laid out format (for example, a Schedule B (Form 5500)), would be sufficient to satisfy this annotation. It should be noted that Annotation 4-2 calls for the actuary to "indicate the extent to which the actuary or other sources are available to provide supplementary information and explanation." Depending upon the circumstances, sources other than the actuary (for example, a principal's management or auditor) may be a better source of supplementary information or explanation. If that were the case, the actuary would normally direct the intended audience to that better source. Many actuaries satisfy this annotation by including in their communications a general invitation to the intended audience to contact them for additional information or assistance.

Precept 5 of the Code requires an actuary to identify the principal(s) for whom the actuarial communication is issued and describe the capacity in which the actuary serves, as appropriate. Many actuaries believe that in communicating to the principal, the capacity in which they serve is unnecessary. However, when the actuary has actual knowledge that the communication is intended for or will be used by an intended audience other than the principal (for example, a regulator), the actuary normally satisfies Precept 5 by disclosing the identity of the actuary's principal and stating that the actuary is working as an employee of the principal or as a consultant, as applicable.

Precept 6 requires the actuary to make "appropriate and timely disclosure" to a present or prospective principal of "the sources of all direct and indirect material compensation" that the actuary or the actuary's firm has received, or may receive, from another party in relation to an assignment for which the actuary has provided, or will provide, professional services for that principal. For example, if a consulting pension actuary's employer offers valuation and investment services where the investment service fees may be offset by asset management fees, the actuary would normally need to make full disclosure of the relationship and the financial impact to the actuary's employer of the combined business arrangement.

Annotation 6-1 offers additional guidance, stating that an actuary who is not "financially and organizationally independent concerning any matter" related to the performance of professional services should disclose to the principal any pertinent relationship that is not apparent. Thus, for example, if the actuary has previously provided professional services to an insurance company, and is asked by a prospective buyer of that company to value the insurer's reserves and liabilities, the actuary would normally disclose the prior relationship with the company to the prospective buyer. Precept 7 (see below) offers additional guidance on this subject.

It can be more challenging for actuaries who work in consulting firms that operate in multiple locations to satisfy Precept 6, because the firm may offer, and receive compensation, for services from another office of which the actuary is unaware. Different firms take different approaches to tracking fees, compensation and conflict of interest under Precept 7 (see below), but it may be helpful to note that Precept 6 does not call for the actuary to investigate all possible sources of material compensation that another branch of the actuary's firm might receive. Rather, the precept limits disclosure to "those sources [of compensation] known to, or reasonably ascertainable by, the actuary." Thus, many actuaries believe that, if their firms maintain a process for checking conflicts of interest and sources of compensation and the actuary makes use of that process, Precept 6 is satisfied.

At the same time, many actuaries agree that Precept 6 calls for the actuary to identify sources of compensation that are reasonably ascertainable and to disclose those sources to the actuary's principal. The extent of effort that the actuary exercises in obtaining such information usually is left to the judgment of the actuary.

Conflict of Interest (Precept 7)

Where an actuary becomes aware of an actual or potential conflict of interest between two (or more) present or known prospective principals, Precept 7 calls for the actuary to, among other things, disclose the actual or potential conflict to the principals. Depending upon the circumstances, it can be difficult for an actuary to know when a potential conflict of interest may arise between principals, especially if the actuary provides professional services to both principals over a period of months or years and their interests change over time. For example, a valuation actuary might issue Annual Statement opinions on behalf of two insurers for several years, building a good working relationship with both. If one of the two insurers decides to buy a block of business from the other, both insurers might look to the actuary to value the block based on positive past experiences. Nothing in Precept 7 would prevent the actuary from undertaking the valuation; nevertheless, to satisfy the precept the actuary would advise both insurers of the potential for conflict between their respective interests. It would then be up to both insurers to decide whether to permit the actuary to proceed with the valuation.

One question that can arise under Precept 7 is *when* the actuary would normally communicate the disclosure to the present or prospective principals of an actual or potential conflict of interest. Every situation is different, and the timing of the disclosure can vary depending on the circumstances. It would not normally be reasonable to expect the actuary to disclose potential conflicts of which the actuary has no reason to be aware. For this reason, many actuaries believe that Precept 7 is satisfied if the actuary discloses the actual or potential conflict of interest to the principals within a reasonable time after the actuary has become aware of the conflict and, in any event, with sufficient notice to give the principals reasonable opportunity to agree or disagree with the actuary providing the professional service.

In some instances, however, it may not be apparent to the actuary that a conflict exists at the time the actuary commences the professional services. In such an instance, upon becoming aware of the conflict, many actuaries would stop work on the professional assignment at issue and would not continue work until the conflict had been disclosed to the principals and the principals had given the actuary permission to continue working.

If the actuary is to satisfy the requirements of Precept 7, it is normally important for the actuary's principals to advise the actuary of their interests relevant to the actuary's work on their behalf. While the interests of an actuary's principals may be readily apparent in some instances, it would not normally be reasonable to expect the actuary to take into account interests of which the principal had never made the actuary aware.

Precept 7 also requires the actuary to consider and advise affected principals of a potential conflict of interest. Although the actuary is not expected to be omniscient, actuaries normally can anticipate the circumstances under which a conflict is likely to arise. Precept 7 calls for the actuary to identify those circumstances and to disclose the potential for conflict of interest as a safeguard for the actuary and affected principals.

CONTROL OF WORK PRODUCT (PRECEPT 8)

Precept 8 requires the actuary to take reasonable steps to ensure that professional services provided by the actuary are not used to mislead other parties. This precept does not impose an absolute obligation on the actuary's part to prevent misuse of the actuary's work, because the actuary may not, in fact, have sufficient control over the principal or other individual to prevent the work from being misused. Consequently, many actuaries believe it is sufficient for the actuary to take steps that are reasonable under the circumstances, if the actuary has actual knowledge that the work product may be misused.

Disclosure can help the actuary satisfy Precept 8. Including disclosures clearly made that are embedded in the work product concerning its intended use and audience, limitations on distribution and use, or other disclosures may make it more difficult for principals or third parties to use the actuary's work in a manner inconsistent with how the actuary intended it to be used. For example, the actuary can state in both the engagement letter, if any, and in the work product itself that "the work product is intended to be used in its entirety and no portion may be extracted on republished without the opportunity of the actuary to review such publication to insure the work product is used as intended."

CONFIDENTIALITY (PRECEPT 9)

Precept 9 takes a different approach to disclosure than other precepts of the Code, addressing information that an actuary should *not* disclosure. Specifically, Precept 9 states that the actuary should not disclose confidential information to any party unless authorized to do so by the principal or required to do so by law. The Code defines "confidential information" as "information not in the public domain of which an Actuary becomes aware as a result of providing Actuarial Services to a Principal. It includes information of a proprietary nature and information that is legally restricted from circulation."

In many instances, it will be clear to the actuary whether particular information is "confidential" within the meaning of Precept 9. However, circumstances can arise where it is not obvious whether information is intended by the principal to be confidential. For example, an actuary might be contacted by an individual claiming to be an agent of the principal seeking information about the principal's business. If the actuary is uncertain whether particular information is confidential, it would normally be prudent for the actuary to ask the principal before disclosing the information to another person. The actuary may also wish to consult with counsel before determining whether the actuary is required by law to release what appears to otherwise be confidential information.

It may also be prudent as part of an engagement for the actuary to agree in advance with the principal about the appropriate representation and information dissemination process of the actuary's work product. Such advance agreement can protect confidentiality of information and can help the principal understand the appropriate use of the actuary's work product. It can also bring to the surface any potential conflict of interest if the principal seeks to make the actuary's work product available publicly or to treat the actuary's work product as the principal's work product.

VIOLATIONS OF THE CODE (PRECEPTS 13 & 14)

Precepts 13 and 14 of the Code address disclosure between the actuary and professional organizations, rather than between the actuary and the principal. Precept 13 requires the actuary to report another actuary's apparent, unresolved breach of the Code to the appropriate counseling and discipline body of the profession, in the U.S., the Actuarial Board for Counseling and Discipline ("ABCD") and, in Canada, to the Committee on Professional Conduct of the CIA. The actuary need not make such disclosure, however, if doing so would be contrary to law or divulge confidential information (see Precept 9 above).

One issue that sometimes arises under Precept 13 is *when* the actuary should disclose the apparent, material violation to the ABCD. It would not normally be reasonable to expect the actuary to disclose a violation of which the actuary was not aware. Many actuaries prefer first to attempt to resolve apparent, material violations with the other actuary, and do not disclose the violation to the ABCD unless and until the attempt at resolution fails. Separately, if the actuary is in an adversarial setting (litigation, for example), the actuary will often defer disclosure until after the court case has been resolved. If confidential information is involved, the actuary normally would not disclose the violation until after receiving permission from the principal to release relevant confidential information to the ABCD.[3]

Precept 14 requires the actuary to respond promptly, truthfully and fully to any request for information by, and cooperate fully with, the ABCD regardless of whether the actuary is the subject of the ABCD's inquiry. The actuary's response is subject to applicable restrictions on confidential information and those imposed by law. To satisfy Precept 14, the actuary would normally disclose to the ABCD any non-confidential information requested by the ABCD except to the extent the actuary was prohibited by law from doing so. The timing of the disclosure is not likely to be in question, because the ABCD usually asks actuaries to respond to its inquiries by a certain date.

[3] It may be worth noting that the treatment of confidential information in respect of investigative and disciplinary proceedings may be different when the actuary is practicing in other jurisdictions. In particular, in Canada, the actuary is required to disclose confidential information to an investigation team and/or a disciplinary tribunal unless the law prevents such disclosure.