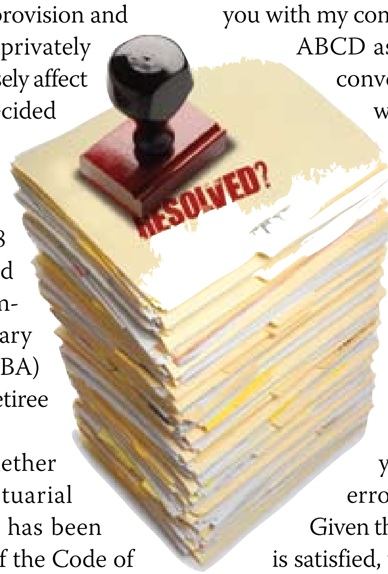
When Is a Violation Resolved?

SARAH MCAREE (FSA, MAAA) HAS A PROBLEM. Sarah was recently engaged by the privately held Argo Fishing Lure Co. to provide actuarial services related to its retiree group-benefit plans, beginning with the 2009 valuation. Jim McNiece (ASA, MAAA, FCA) had announced he would be retiring at the end of 2009, and Argo decided to engage Sarah's services now rather than wait. The first step in her process for taking over this assignment was to obtain a copy of the 2008 census data from Jim and attempt to replicate his 2008 valuation results. After several weeks spent setting up her valuation system to handle Argo's plan, running the valuation, comparing the results, and tracking down the differences, she realized that McNiece had made a mistake in valuing a plan provision that was first reflected in the 2008 valuation. The mistake overstated Argo's obligation by about 10 percent. Sarah contacted Jim to discuss what she had found. After hearing Sarah's explanation and checking his own system's results, Jim agreed that he had misunderstood the plan provision, resulting in the error.

Sarah and Jim met with Stu Waters, CFO of Argo (and one of its five shareholders) to discuss the situation. Stu called in the company's president and its auditor. All agreed with Sarah's interpretation of the plan provision and her valuation results. Since Argo is a privately held company and the error didn't adversely affect Argo's creditors, Stu and the auditors decided to reflect the correction by restating the December 2007 balance sheet (which had included the plan change) and correcting the 2008 expense in the 2008 financial statements. They also planned to reflect the corrected values in the company's 2008 contribution to its Voluntary Employees' Beneficiary Association (VEBA) trust and the tax deduction it takes for retiree group benefits.



DREAMSTIME

Sarah's problem is in deciding whether Jim's apparent failure to provide actuarial services with sufficient skill and care has been resolved. Is she bound by Precept 13 of the Code of Professional Conduct to report it to the Actuarial Board for Counseling and Discipline (ABCD) as an unresolved apparent material violation? She has heard many views about resolving violations at the actuarial meetings she has attended and isn't sure which to follow.

Sarah is concerned, so she decides to contact the ABCD for guidance. She sends an e-mail to the ABCD outlining the situation and asking to be contacted by one of its members. ABCD member Alice Wicksteed calls Sarah the next day. Let's listen in on their conversation.

WILLIAM J. FALK is a principal with Towers Perrin in Chicago. He is also vice chairperson of the Actuarial Board for Counseling and Discipline.

Alice: Sarah, your request for guidance was forwarded to me. I read your summary of the situation and am happy to discuss it with you. You need to realize that I will provide you with my comments and opinions, and not those of the ABCD as a whole. I will share a summary of our conversation with the other members so that we are all aware of the advice being given. Beyond that, our conversation is entirely confidential.

Sarah: I really appreciate your calling. In my e-mail, I set out the situation as completely as I could. I'm eager to hear your thoughts about it.

Alice: As you know, Precept 13 requires an actuary to report to the ABCD an apparent unresolved material Code violation of which the actuary is aware. I infer from your e-mail that you clearly think that the error in Jim's work was a material violation. Given that he has corrected the error and the client is satisfied, why do you have concerns about whether or not the violation has been resolved?

Sarah: You're right; I definitely think the error was material. I have taken over five cases from Jim over the past two years as he has been reducing his practice. I found at least one mistake in four of the five cases. The other mistakes weren't as significant as this one, so I didn't think twice about them at the time. No one is perfect. This latest mistake was definitely significant enough for me to be concerned. And just because everyone agreed that neither the five shareholders nor the creditors were hurt by it, they could have been, especially if the error had been an understatement rather than an overstatement. I'm not sure that merely correcting the error is enough to resolve it. What do you think?

Alice: First of all, I believe that Precept 13 leaves the decision up to the actuary who is aware of the violation. I can't see the ABCD second-guessing an actuary who makes a good-faith decision, as long as the actuary has a reasonable basis for the decision. Second, my personal approach to deciding whether a violation is resolved or not is to consider a few questions:

- Is it likely that this is part of a pattern of lack of care or skill in performing actuarial services, or is it an isolated incident?
- Despite the correction, is the violation such that its having occurred adversely affects the reputation of the profession?
- Despite the correction, is the violation so egregious that I am uncomfortable unless more is done about it?

If I were to answer yes to any of these questions, I would submit a complaint unless prevented by confidentiality or some other restriction.

Sarah: That makes sense. I'll have to think this over some more. If I decide to submit a complaint, how do I do it?

Alice: You should send your complaint in writing to the ABCD at the Academy's offices. The complaint must be signed and should identify the actuary and the conduct that you think is a violation of the Code. Supporting evidence is always helpful. You can find more details on submitting a complaint by going to www.abcdboard.org.

Sarah: Thanks, Alice. You've been a great help.

Precept 13 places a responsibility on all members of U.S. actuarial organizations to report apparent unresolved material violations of the Code, unless confidentiality or other legal factors prevent them from doing so. But Precept 13 also encourages them to first attempt to resolve the violation.

As it is for Sarah, deciding whether or not a particular apparent violation has been resolved can be difficult.

It's sometimes argued that no violation can be resolved, because the conduct can't be erased. This is felt to apply particularly to violations involving ethical conduct. The fact that the ethical act is reversed doesn't eliminate the effect it had on the reputation of the profession. An alternative view is that if the actuary admits the violation and corrects it to the satisfaction of all parties, it's resolved and needn't be reported.

A middle ground recognizing that some violations can be resolved by taking corrective action seems reasonable, especially if the corrective action is satisfactory to all known affected parties. But this approach also recognizes that the violation may still be unresolved if it's part of a pattern of inadequate work or questionable behavior or is so significant that it should be investigated further. ●