ACTUARIAL EVIDENCE SEMINAR; SEPTEMBER 9, 2011

SESSION 4 - REVIEW OF THE ACTUARIAL EVIDENCE STANDARDS

IAN KARP'S REMARKS

Introduction

This session is to report on the activities of the ASB Designated Group ("DG") chaired by Nancy Yake, which is looking at the AE standards (other than marriage breakdown), and certain parts of the General Standard which affect AE work. Nancy Yake and Normand Gendron are providing a detailed presentation today re the DG's activities.

I am a member of the DG. My role today is to comment from the point of view of an actuary doing "traditional" AE work; i.e. work **NOT** arising out of another actuarial practice area such as pensions or life insurance. I will focus my remarks on the effects on injury and fatality work of the Standards, and the changes proposed in the DG's May 11, 2011 Notice of Intent ("NOI"). As most of you know, I practice in B.C. and my comments will be from that perspective. These are my personal views only.

I first describe what the NOI essentially proposes, then discuss the Current Standards (and in a few cases my suggested changes) as they affect a few key issues:

- What restrictions, if any, should there be on an actuary's ability to value scenarios?
- What actions and practices need to be ruled out by our Standards?
- Should varying one's opinion as between plaintiff's work and defendant's work be allowable?
- Should acting as an advocate be allowable?

Essentially, What Does The May 11, 2011 NOI Propose?

Review Standards

It has been at least 7 years since the AE Standard was last looked at, so the NOI says it would be a good idea (both in the public interest and the profession's interest) to review them.

Major Overhaul Not Contemplated

The aim is essentially to tweak the AE Standard; i.e. update it, clarify it, ensure consistency. The aim is **NOT** to overhaul it in a major way.

Do Some AE Practitioners Want A Seinfeld Standard?

In my experience, when the topic of AE Standards is raised, many AE practitioners respond that the Standard should be as brief and as permissive as possible. Taking this view to its extreme, the ideal Standard would be, as has been said about the Seinfeld TV show, about nothing.

Practitioner Views

I base the following on many discussions I have had with actuaries over the years. While the following illustrative quotes from two leading AE practitioners are from year 2000 (CIA meeting session) I suspect they still represent the views of at least some AE practitioners; I look forward to comments on this in the question period.

One practitioner said:

"...I'm really concerned that we may be going the wrong way [if we made] detailed rules. I'd rather see something very short that required honesty, of course, disclosure,...mathematical accuracy...[I]t doesn't really bother me if somebody else, or me, wants to use the superman mortality table, or minus ten percent interest. Because, I assume the other side has hired [another actuary] who is going to point that out. And...the courts will just throw it away if it's garbage.....[c]ount on...the adversarial system, to make it work."

By the way, the value of a $1 annual life annuity to a 60 year - old person, based on the superman mortality table (live to 100 with certainty and then die with certainty of a green kryptonite attack at age 100); and -10% annual net discount rate, is 633.22.

Another practitioner said:

"I believe the role of the actuary, in the adversarial tort system, is to value scenarios. I don't think that our standard should be a complex document that tries to rule out certain scenarios. I believe we should make more use of educational notes [to explore professional issues but we] have to keep our standard simple."

Views Of AE Committee

The above views (leaving aside the above colourful example) have essentially been generally supported over the years by the AE committee. The then Chair, Tom Walker, stated in 1997:

"The objectivity definition(s) must be strong enough that the actuary is prevented from changing his or her "opinion" from case to case yet not so restrictive that the actuary cannot legitimately present feasible alternatives as required. In all situations, it is important that the actuary disclose the terms of reference for the assignment."

Current AE chair Kelley McKeating (pp. 4-5), writing on behalf of the AE committee in a July 15, 2011 submission to the DG, stated:

"The revised standard should not be prescriptive as to specific assumptions...The range of assignments covered...is wide, and cannot be foreseen. Any attempt to prescribe assumptions is almost certain to lead to situations where the prescribed assumptions don't make sense, and subsequently to situations where non - actuaries are better positioned to serve the public and the courts because they are not constrained...

We do not believe it is appropriate to consider any revisions to the SOP to "narrow the range of practice." AE work in the injury and fatality fields [which constitutes the majority of the actuarial work performed under Section 4000] is highly varied. Each fact situation is different from almost every other one. The scope of the actuary's assignment will also differ...depending on the involvement of other experts...and the information that the lawyer needs."

Views Of DG; May11, 2011 NOI

The NOI's views are similar:

"At this point, there is no intention to significantly expand the AE Standards or to significantly narrow the range of practice...Nevertheless, if the input received in response to this [NOI] suggests [otherwise]...the Designated Group will reconsider this issue.

To date parts of the AE Standards have been worded in a somewhat general manner, in recognition of a wide range of applicable legislation and court practices, which can vary significantly by jurisdiction. It is intended that any changes made to the AE Standards and certain relevant parts of the General Standards would continue to take into account this consideration."

Does Our Current Standard Allow Us To Just "Value Scenarios" (i.e. Accept Lawyers' Instructions) Without Restriction?

General Standards

As mentioned, the DG is looking at certain aspects of the General Standards, and certain passages from the General Standards are important to AE work. The concept of "appropriate engagement" is particularly important; it is defined in the General Standards (paragraph 1100) as follows:

"[An engagement] that does not impair the actuary's ability to conform to the rules."

So, you will very likely be fine as long as you avoid being dishonest (Rule 1), act with integrity (Rule 1), only do work you know how to do and do it carefully (Rules 1, 2 and 3), avoid improper conflict of interest (Rule 5), and don't go along with anything misleading (Rule 6).

The General Standards elaborate further on what is or is not an “appropriate engagement”, and state at sub - paragraph 1410.06:
“An engagement’s appropriateness is not likely affected if the actuary’s client or employer selects particular assumptions...and the report describes the assumption and identifies the source, or chooses a value for certain assumptions from within a range selected by the actuary.”

This would be definitive if not for the use of the word “likely”.

The fundamental question is; can it ever be “acting without integrity” (i.e. contrary to Rule 1) to accept a client instruction? But this is left unanswered.

AE Standard

Sub - paragraphs 4230.02 and 4230.03 of the AE Standard state as follows:
“The actuary should ensure that any assumptions selected by the client are plausible, taking account of applicable law...

In reporting, the actuary should identify which assumptions have been selected by the client.”

My dictionary defines plausible as “apparently reasonable, valid, truthful...”. But the Standard gives no further elaboration on “plausible”. This is in line with the view that the Standards be brief. Further, to my knowledge and recollection, it has not come up for discussion at the annual AE Seminar, since the Standard was adopted in 2003/2004. I must confess I did not realize it was there until preparing this paper.

So the practical effect of this is difficult to determine.

The AE committee states in its July 15, 2011 document (p. 9):
“The requirement for the assumption to be plausible should remain.”

Comments

It appears that our ability to value scenarios is indeed restricted to those that are “plausible”. I strongly support the current Standard in this regard, although I would not necessarily be against replacing “plausible” with alternative language.

We all have our personal views on this in a “best practices” context; mine are outlined at my website. Briefly, I think we should try at times to influence lawyers’ instructions so they are more moderate, and not follow instructions which are clearly unreasonable. I do not think we can ever accept instructions about purely actuarial matters; that would impair our independence.

So If Our Standard Should Not Be A Seinfeld Standard, But Rather Rules Out Some Actions, What Other Actions And Practices Should Be Ruled Out?

Of course, nobody really wants a Standard that is literally "about nothing". As a profession, we pride ourselves on having Standards. Thus, the CIA's June 1, 2011 submission re Ontario rules 53.09 and 53.10 states:

"...[A]ctuaries who provide [services re injury and fatality cases] have a duty to the parties and the court to provide opinion evidence that is fair, objective and non - partisan."

But for the Standard to be meaningful, it cannot just rule in various practices and actions. Certain practices and actions must be ruled out. We have already seen that client assumptions cannot be accepted if they are not "plausible". Which other practices and actions should be ruled out?

Historically, What Violations Of Accepted Practice
Has The Profession Clamped Down On?

A first step is to look at history. I discuss three examples below. Only the first arose from injury / fatality work, but the three collectively illustrate to what extent there are "teeth" in our Rules and Standards. The first two examples are from the 1980's and 1990's. The third is more recent.

The first example was a systematic use of the annuity certain method to calculate future losses in place of the best estimate, or actuarial present value method. The AE committee issued a public statement, essentially saying that the annuity certain method was not allowable. This led to a reduced use of the method, although it did not stop its use entirely. It also led to our Standards (see paragraph 4130) being revised to specifically refer to and endorse the actuarial present value method.

The second example involved actuarial testimony accepted by the Courts that the law mandating interest rates over 60% per annum as criminal, should be reinterpreted as establishing a "dividing line" of "60% compounded continuously" or about 82% ("e" raised to the power .6, minus 1). The AE committee again acted, publicly reaffirming that 60% should be applied, NOT 82%. This statement halted the practice of using 82% in its tracks.

The third is a more recent example involving "Actuary B" testifying in court re a pension plan asset valuation method used by "Actuary A". Actuary B's evidence was rejected by the Court, the Court finding that he "placed himself in the role of an advocate". He was charged by the CIA, but found innocent by a Disciplinary Tribunal ("DT"). My view is that Actuary B got into trouble mainly because he let the client have too much influence over the wording of his report. But the DT found him innocent essentially because the DT said he came to his initial opinion on the core issue independently, and the input from the client did not change that core issue opinion. I think the lesson here is that, aside from changes in instructions or pointing out obvious errors or typos, the client should have little or no

input into the wording of the actuary's report.

One Thing We Do And Should Restrict; Having One Set Of "Plaintiff's Assumptions" And Another Set Of "Defendant Assumptions"

As already mentioned, then AEC chairperson Tom Walker said in 1997:

"**The objectivity definition(s) must be strong enough that the actuary is prevented from changing his or her "opinion" from case to case** yet not so restrictive that the actuary cannot legitimately present feasible alternatives as required. In all situations, it is important that the actuary disclose the terms of reference for the assignment." (Emphasis added)

Provisions In Current Standards

Do our current Standards prevent an actuary from selecting one set of assumptions when acting for the plaintiff (so as to maximize losses)and another set when acting for the defendant (so as to minimize losses)? The following indicates that the answer is "yes".

General Standards

First, consider the definition of "best estimate" in paragraph 1100 of the General Standards:

"without bias, neither conservative nor unconservative."

"Bias" is not defined in our Standards, but perhaps it should be.

Paragraph 1430 states (in part) as follows:

"The financial interest of the actuary's client...should not influence the result of the actuary's work except to the extent that the client or employer selects methods or assumptions for the work.

....[I]t may be in the client's or employer's interest to maximize or minimize the result. That is usually the case when the actuary's client is one side of opposing interests; for example, the plaintiff or defendant in litigation...

In such a case, the actuary's duty of professionalism supersedes the duty of service to the client or employer...

[This] does not preclude the actuary's use of methods or assumptions selected by the client or employer in an appropriate engagement, but the actuary would report such use."

Provisions In AE Standards

Sub - paragraphs 4230.01 and 4230.05 of the AE standards state as follows:

"The actuary's assumptions to calculate the capitalized value of amounts payable in respect of an individual should be best estimate assumptions unless there is a reason for biased assumptions. Except where the assumption is required by law, the actuary should report any such reason and the resulting bias...

Requirement by law is a satisfactory reason for using a biased assumption."

My Views Re Current Standards; Suggested Changes

Based on the above, I think that the current Standards do prevent an actuary varying his/her opinion according to whether he/she acts for plaintiff or defendant. Of course, a practical issue is that some actuaries may do most or all of their work for one side, and then the applicability of this point is uncertain.

The clearest part of the Standards on this point is General Standards, 1430, but this is so important in AE work that I think it bears repeating and/or elaboration in the AE standards.

For example, we could essentially repeat 1430 and then also say:

"Assumptions selected by the actuary cannot vary according to whether the actuary acts for the plaintiff or defendant. Thus, in two similar cases, one plaintiff, one defendant, assumptions selected by the actuary must be the same between the two cases, or if different the difference would need to be attributable to factors other than whether the actuary was retained by the plaintiff or defendant."

Further, I think that we should be extending the concept to report language, not just assumptions.

Another Thing We Should And Do Rule Out; Acting As An Advocate

Since 2010, the B.C. Courts have required that experts state the following in their reports:

"I am aware of my duty to assist the court and not to be an advocate for any party. I have written my reports in conformity with that duty. I will, if called on to give oral or written testimony, give that testimony in conformity with that duty."

My understanding is that other provinces may already have, or are considering, similar requirements.

This subject is covered in our AE standards, paragraph 4150:

"The actuary's testimony should be objective and responsive. The actuary's role as an expert witness in court is to assist the court in its search for truth and justice, and the actuary is not to be an advocate for one side of the matter in dispute."

I have already discussed the need for best estimate assumptions, not varying assumptions by which side you're on, and only accepting instructions which have some degree of reasonableness.

More fundamentally, advocacy implies at least the potential (depending on the subject matter of the actuary's report and/or questions asked in Court) of a dishonest response to a question, which is of course contrary to Rule 1.

My dictionary defines “advocate” as :
“a person who upholds or defends a cause...a person who pleads his or her client’s case in a court of law.”

Thus there is already an advocate in the courtroom, the lawyer; the actuary cannot become one.

This does not preclude an actuary from:
a. Having honestly - held views that largely coincide with the client’s case.

b. Helping the lawyer do his/her job. Indeed, from a best practices point of view, I think an actuary has two separate, distinct roles; the first is writing reports/giving testimony (subject to Standards). The second (NOT subject to Standards, or at least not to the same detailed Standards as written reports or oral testimony - the Rules still apply) helping the lawyer do his/her job. Examples of the second role would be advising the lawyer as to recent case law, or helping the lawyer prepare for cross examination of an opposing expert. Note that the above required B.C. language relates strictly to the actuary’s direct input to the court; i.e. written report or oral testimony.

This **DOES** preclude an actuary from writing reports or giving testimony which has the aim of putting his client’s case in the best light, rather than following paragraph 4150 (dealing with “Testimony”).

We Really, Really Need Educational Notes
Almost everyone involved with AE standard - setting has been saying “keep the Standards brief”. But there’s also virtual unanimity that Educational Notes would be desirable, and this was a big topic of conversation in the 1998 - 2000 period when I was AE committee chairperson.

Well, it’s now 2011 and we still have no AE Educational Notes (I take my share of the blame). There is a lot of good material out there. As a starting point, the AE Skills and Knowledge Inventory (“SKI”) is available at:
http://www.actuaries.ca/members/publications/2008/208096e.pdf

What remains to be done is cataloguing everything that’s out there, assembling it, vetting it, and putting it on the website in a user - friendly manner.

Concluding Remarks
I think our current Standards do strike an appropriate balance between allowing actuaries freedom to respond to the demands of daily practice on the one hand, while appropriately restricting unethical practice on the other. But we have an opportunity now to revisit and improve the current Standards. I look forward to hearing others’ views.