

The Ethical Actuary

We must be aware of ethical dilemmas and how to resolve them. These can be the most challenging decisions we have to make.

BY RICHARD KUTIKOFF



If you're not losing sleep because of ethical concerns, you probably have ethical problems. All right, perhaps that statement is a bit too strong, but nonetheless...

The daily choices that actuaries typically face are largely technical in nature. Ours is a technical profession requiring years of training and examinations, a formal licensing process and continuing education requirements. But we also make recommendations that affect our clients, as well as decisions impacting our own careers and businesses.

Here is where it can get tricky. To illustrate, have you ever thought about:

- Changing your interest rate assumption by a mere 0.5% (pre-PPA) or adjusting your retirement age assumption by just a year or two (post-PPA) to change the minimum required or maximum deductible contribution for a client?
- Accepting client data that you simply didn't trust?
- Steering a client to an advisor who sends you business, even though you believe the advisor is inappropriate for your client?
- Recommending a pension plan primarily to increase your fees, or advising against a 401(k) plan because you don't work on 401(k) plans?
- Delaying signing an AFTAP certification so your client's favorite employee can receive a lump sum?
- Unfairly blasting the incompetence of prior work on a takeover case?
- Providing inadequate cooperation with the new actuary when the relationship with the client has soured?

We generally think of ourselves as being ethical professionals. So, our answer to each of these questions is "of course not." Really? Many actuaries surely have at least *considered* some of these questions. But what did you actually do?

DO ETHICS MATTER?

What are the consequences of poor ethical choices? If you get caught, it can hurt your reputation, your firm's reputation and the profession's reputation. You can get fired. You can get sued. You can lose your license.

What's the difference between ethics and professionalism? While ethics might be broader, *does it really matter* whether an action is a violation of Circular 230, ASPPA's Code of Professional Conduct, or an ASOP? Let's look at three types of dilemmas:

1. Obvious Violations

These are situations where few actuaries would be comfortable; none should be. They include:

- stealing money from a plan;

- forging a client's signature or backdating; and
- lying to an IRS representative.

2. Unfairly Using Your Information Advantage

Professionals know more than their clients, and can take advantage of that knowledge. Examples include:

- Grossly overcharging. (You know more about market prices for services than the client.)
- Changing assumptions to meet client needs. (You know the benefits your client has promised his employees are more expensive than you led him to believe. However, the client doesn't take kindly to hearing bad news.)
- Using questionable data. (After all, if audited, the client gets hurt. You believe you're protected because the client signed off on the data.)
- Blaming the previous actuary. You suspect the real culprit was the client or referral source (bad data, late responses, etc.), but you cannot say that to get the business.

3. Potential Conflicts of Interest

These are more subtle. Actuaries' work impacts many interested parties: the plan sponsor (or different senior executives including the one who hired us), plan participants and beneficiaries, our own employer. To whom does the actuary owe loyalty?

Where do you draw the line with the following two potential conflicts? First, between the plan sponsor and plan participants or beneficiaries:

- recommending plan design changes
 - determining when to prepare AFTAP certifications
 - correcting benefit calculation or allocation errors
 - consulting on QDROs
- Second, between the plan sponsor and the actuary's employer:
- suggesting complex, expensive plan designs
 - avoiding less expensive solutions that you do not offer
 - running up charges for a fee-insensitive client

- not disclosing indirect fees

WHAT SHOULD YOU DO?

Some situations are black and white. For example, it's a good idea to avoid embezzlement. Others are less clear. A blueprint for dealing with the gray area should include these principles:

- Before you act, step back. Think how you would defend the action you are about to take. You might have to answer to your client, your boss, the ABCD, the Joint Board, a reporter or an attorney in court.
- Ask your boss or another actuary for advice; they have probably dealt with this before. Or ask the ABCD for guidance.
- Understand not only the technical rules (ERISA, Internal Revenue Code), but also the rules of practice — Circular 230, ASOPs, JBEA regulations, etc. When confronted with an ethical dilemma, take the time to review the applicable rules of practice. Most actuaries probably cannot cite the exact ASOP paragraph of a potential violation from memory. This may not be the most exciting reading, but it is worthwhile. You might even find guidance that is exactly on point for your specific situation. (The author has found it very effective to say "under the Rules of Professional Conduct, I am not allowed to _____.") If guidance doesn't apply precisely, at least you have a starting point.
- In potential conflict of interest situations, communicate (in writing). This makes all parties explicitly aware of the situation, and enables them to properly judge your recommendations. It looks bad if you're accused of hiding something.
- Sometimes, there are clear right or wrong answers. Other times, reasonable people may disagree. Maybe the best solution is to avoid getting into a questionable situation — and if you're already there, consider resigning.

THE RATIONALIZATION TEMPTATION

It's easy to say, "Nobody will know," "Everyone's doing it," "Who gets hurt if the pension plan covers only the owner?" or "There isn't enough time or budget to do the work properly." When temptation strikes, please refer to the "before you act, step back" bullet point above.

For those who prefer actuarial jargon, actuaries pride ourselves on our ability to identify and evaluate risks, and to provide risk management solutions:

- The risk can either be transferred (buy insurance) or assumed (self-insurance).
- Self-insuring makes sense when the amount of potential loss is small, no matter the likelihood of the triggering event. (Do you really need to buy that extended warranty on a \$30 toaster?)
- Buying insurance makes sense when the amount of potential loss is large, even if the likelihood of the triggering event is small. (Do you really want to lapse the fire insurance policy on your home?)
- If the amount of potential loss is large and insurance cannot be obtained, the likelihood of the triggering event must be reduced.

Here, the triggering event is committing the ethical violation; the potential loss is your license. The solution: don't do it.

NO 'ONE SIZE FITS ALL'

Learn to recognize ethical dilemmas. However, there are no simple formulas — just guidelines and your good common sense. Your reputation took a long time to build, but can be ruined quickly. After all, what do you have professionally if not your reputation? **PC**

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