

**IN THE COURT OF APPEALS**

**STATE OF ARIZONA**

**DIVISION ONE**

CHARLES R. COHEN, Receiver,	)	1 CA-CV 02-0299
and MARK D. THARP, Special	)	
Deputy Receiver of AMS Life	)	Maricopa County Superior
Insurance Company, and Arizona	)	Court No. CV92-05232
insurer, in receivership,	)	(Petition No. 258)
	)	
Petitioners-Appellees,	)	
	)	
v.	)	
	)	
J. HUELL BRISCOE &	)	
ASSOCIATES, INC., an Illinois	)	
corporation, JEROME S. COMM,	)	
an individual, and BRUCE	)	
JACKSON, an individual,	)	
	)	
Respondents-Appellants.	)	
_____	)	

**BRIEF OF *AMICUS CURIAE*  
AMERICAN ACADEMY OF ACTUARIES  
IN SUPPORT OF APPELLANTS**

Lauren M. Bloom, General Counsel and  
Director of Professionalism (admitted *pro hac vice*)  
American Academy of Actuaries  
1100 17th Street, N.W.  
Washington, D.C. 20036  
(202) 223-8196

Attorney for the American Academy of Actuaries

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Attorney for the American Academy of Actuaries

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## STATEMENT OF INTEREST

The American Academy of Actuaries (the “Academy”) submits this *amicus curiae* brief because, for the reasons discussed below, this Court’s decision has the potential to significantly impact members of the Academy practicing in this jurisdiction.<sup>1</sup>

The Academy is a not-for-profit professional association incorporated in Illinois with its primary place of business in Washington, D.C. The Academy was established in 1965 to provide a common membership organization for actuaries of all specialties (*e.g.*, property and casualty insurance, health insurance, life insurance and pensions) practicing in the United States. The Academy’s membership is approximately 15,000 actuaries nationwide, or 85% of all the actuaries practicing in the United States.<sup>2</sup>

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<sup>1</sup> The Academy takes no position with respect to the specific facts of this case.

<sup>2</sup> The Academy has four sister organizations in the United States: the Society of Actuaries and the Casualty Actuarial Society, which administer the profession’s examination system; the Conference of Consulting Actuaries, which provides continuing education and other services to consulting actuaries; and the American Society of Pension Actuaries, an organization for professionals (including actuaries, attorneys, accountants and plan administrators) who provide services to pension plans under the Employee Retirement Income Security Act, 29 U.S.C. § 1101 *et seq.* (“ERISA”). These organizations look to the Academy as the organization with primary responsibility for fostering actuarial professionalism in the United States.

The Academy is the actuarial profession's primary vehicle for public policy outreach, communications, and professionalism, operating under the following

Mission Statement:

As the organization representing the entire United States actuarial profession, the American Academy of Actuaries serves the public and the actuarial profession both nationally and internationally through:

- a. establishing, maintaining, and enforcing high professional standards of actuarial qualification, practice, and conduct,
- b. assisting in the formulation of public policy by providing independent and objective information, analysis, and education, and
- c. in cooperation with other organizations representing actuaries
  - representing and advancing the actuarial profession, and
  - increasing the public's recognition of the actuarial profession's value.

Mission Statement, *Strategic Plan 1998-2003 of the American Academy of Actuaries* (1998).

The Academy fulfills its mission with respect to actuarial professionalism in several ways. The Academy is home to the Actuarial Standards Board, the body responsible for establishing standards of practice to guide actuaries as they

perform a wide range of professional services. Additionally, the Academy supports the Actuarial Board for Counseling and Discipline, the body charged with investigating complaints against actuaries, counseling actuaries in professional practice, and recommending appropriate discipline to the membership organizations for actuaries who are found to have breached the profession's standards. The Academy maintains the Joint Committee on the Code of Professional Conduct, a committee charged with developing the ethical standards imposed upon member actuaries by the Academy and all of its sister organizations.<sup>3</sup> The Academy also, through its Committee on Qualifications, establishes qualification requirements for members practicing in the United States. In addition to these functions, the Academy maintains numerous committees that focus on various aspects of actuarial professionalism. These committees report to the Academy's Council on Professionalism, an oversight body chaired by a Vice President of the Academy. The Council is responsible for ensuring that the Academy fulfills its responsibility to foster a high level of professionalism among members of the actuarial profession.

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<sup>3</sup> The Academy and its four sister organizations have all adopted the *Code of Professional Conduct*. Members who fail to comply fully with the *Code* are subject to discipline up to and including expulsion from membership in the organizations.

As the organization with primary responsibility for representing and advancing the actuarial profession in the U.S., *see Mission Statement, supra*, the Academy occasionally files *amicus curiae* briefs in cases that have the potential to directly impact actuaries in their professional practice. This is one such case. The lower court's findings of fact and conclusions of law, especially when read in conjunction with its Minute Entry of September 5, 2002, appear to hold the Appellants, J. Huell Briscoe & Associates, Inc., Jerome S. Comm and Bruce Jackson (collectively, "Appellants") significantly responsible for the failure of the AMS Life Insurance Company. Appellants have raised on appeal important issues concerning the role of actuaries in insurance companies and the applicability of the actuarial profession's standards of practice. If this Court addresses Appellants' arguments without a fully informed appreciation of the nature and scope of actuaries' professional responsibilities and the standards that the actuarial profession requires them to meet, the Court could issue an opinion that would impose an undue burden on all of the actuaries practicing in this jurisdiction. The Academy, therefore, has a compelling interest in providing this Court with the necessary information to reach a decision that appropriately recognizes the scope of actuaries' responsibilities and the applicability of the professional standards by which they are bound.



## SUMMARY OF ARGUMENT

Actuaries play a unique role in the identification, quantification and development of strategies to handle contingent risk in the insurance and financial services industries as well as employee benefit programs,<sup>4</sup> but actuaries do not work alone. To function effectively, actuaries must work cooperatively with and be able to rely upon the expertise and integrity of other professionals and, in particular, of company management. It is management, not the actuary, who is ultimately responsible for the successful operation of an insurance company. Moreover, insurance regulators have important oversight responsibilities that, if left unfulfilled, can delay recognition of and/or exacerbate an insurance company insolvency. It would be inappropriate to hold actuaries responsible for the ongoing and overall solvency of insurance companies.

Valuation opinions issued in support of insurers' annual statements are carefully defined statements of opinion (not of fact) concerning the adequacy of an insurer's reserves to meet its contractual obligations to policyholders over a limited period of time based on an actuary's analysis of projected future contingent events. Actual events rarely, if ever, conform exactly to the actuary's

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<sup>4</sup> For clarity's sake, this brief will refer hereafter exclusively to the professional services that actuaries provide to insurance companies.

projections, and many factors unrelated to the level of policy reserves held by a company can affect its overall solvency. Valuation opinions should not be construed or relied upon as guarantees of insurer solvency.

Actuaries are not auditors, and do not audit the data underlying their opinions. Rather, actuaries look to company management to provide them with data that is both complete and accurate and to the company's auditors to certify that the data are complete and accurate. In fact, applicable Arizona laws make specific provision for actuaries to rely on management to provide such data. The lower court erred to the extent that it found that actuaries are responsible for auditing the data that management provides.

Actuarial standards of practice provide important guidance to actuaries, but such standards are not binding upon actuaries until their effective date. Standards of practice typically reflect the efforts of the Actuarial Standards Board to describe "generally accepted" actuarial practice and, therefore, can provide some evidence of what "generally accepted" practice was prior to their development. However, in some situations actuarial practice has not evolved to the point where a particular practice or practices have become "generally accepted" and, therefore, the Actuarial Standards Board is called upon to define what practice(s) will be accepted within the profession. In such situations, standards should not be

deemed to reflect generally accepted practice prior to the date of their adoption.

Actuarial Standard of Practice No. 11, *The Treatment of Reinsurance Transactions in Life and Health Insurance Company Financial Statements*, is an example of a standard developed in such a situation. The lower court erred to the extent that it looked to the requirements of that standard with respect to the treatment of reinsurance as evidence of generally accepted practice prior to its adoption.

## ARGUMENT

### **I. Valuation Actuaries Function As Part of a Team of Professionals Advising Insurance Company Management**

The Academy recognizes that the public has a significant interest in the financial security of the institutions to which actuaries provide professional services, and that it is therefore important for actuaries to do so with a high degree of integrity, care and competence. Actuaries apply to their professional assignments a sophisticated knowledge of mathematics, statistics, risk theory, interest theory, finance, and modeling with a broad understanding of accounting, financial reporting principles and applicable laws and regulations. As such, they play a unique role in the identification, quantification and development of strategies to handle contingent risk in the insurance industry.

However, actuaries do not work alone, nor do they typically assume responsibility for the overall financial security of the entities they serve. To function effectively, actuaries must be able to work cooperatively with and rely upon the expertise and professional integrity of accountants, auditors, claims adjusters, and attorneys. These individuals have differing and complementary skills and responsibilities, and each fulfills a critical function in advising insurance company management. Just as an attorney or auditor cannot reasonably be

expected to provide a reserve valuation, an actuary cannot reasonably be expected to provide legal advice on the effects of ambiguous language in a contract or audit the data presented by the company. Actuaries, accountants, auditors, attorneys and other professionals work together to advise insurance company management, which bears the ultimate responsibility for the company's successful operation.<sup>5</sup> For example, an actuary may recommend the level of reserves that an insurer should hold to meet its obligations in the coming year, but it is management, not the actuary, that ultimately determines the level of reserves to be held.

Insurance regulators also have important oversight responsibilities that, if left unfulfilled, can delay recognition of and/or exacerbate an insurance company insolvency. Although the preparation of an insurance company's annual statement (of the sort at issue in this case) may provide management with useful information, the primary purpose of the annual statement is to give regulators the necessary

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<sup>5</sup> The responsibilities of consulting actuaries, in particular, are limited both by the scope of their individual assignments and by their access to information about the companies they serve. When an actuary serves as a consultant, he or she typically undertakes to perform only those assignments that are specifically requested by management. Consulting actuaries also must depend upon company management and the other professionals who work for the company to provide them with complete and accurate data and other information to support their professional opinions and typically have access to only such materials (for example, policy forms, claims data, reinsurance agreements, etc.) as their clients provide to them.

information to review the company's financial condition and, if necessary, inquire more deeply into its operations. State statutes also provide for periodic regulatory examination of insurance companies and require regulators to place companies into receivership when their continued viability is in question. *See, e.g.,* A.R.S. §20-219 (requiring the Arizona director of insurance to refuse to renew or revoke or suspend an insurance company's certificate of authority to do business in the state if the company becomes insolvent). Timely regulatory intervention can prevent or reverse an insurance company failure.

For these reasons, it would be inappropriate to hold actuaries responsible for the ongoing and overall solvency of insurance companies. The advisory role that actuaries play is a crucial one, but it is played in concert with the various responsibilities undertaken by other professional advisors, company management and regulators, and it is not appropriate for those individuals to seek to shift their own responsibilities to the actuary.

## **II. An Actuarial Opinion Is Not a Guarantee of Insurer Solvency**

State statutes require an insurer to file with the department of insurance in every state in which it does business an annual statement of its financial condition. The annual statement must be accompanied by a statement of opinion, issued by a qualified actuary, concerning the adequacy of the insurer's reserves. Specifically,

the actuary who issues such an opinion, or “valuation actuary,” is required to opine as to whether the company’s reserves make good and sufficient provision for its liabilities over the coming year based on moderately adverse conditions and to opine on whether the reserves are calculated in accordance with generally accepted actuarial practice. This is simply an expression of professional opinion based on assumptions that, in all likelihood, will not be entirely consistent with facts as they emerge. It is not, on its face, a valuation of the company’s assets, a guarantee of the company’s continued financial viability or a representation of fact concerning the company’s overall financial condition. Many factors unrelated to the level of policy reserves held by a company can affect its overall solvency, including product development, pricing and marketing, asset management and investment policies, changes in underwriting practices, mismanagement of expenses and management fraud. In sum, an actuarial opinion is not an assurance that the company will not fail under any circumstances.

### **III. Actuaries Do Not Audit Insurer Data**

Appellants’ Opening Brief raises questions concerning the extent to which valuation actuaries can reasonably be expected to uncover flaws in data provided by the company. *See* Appellants’ Opening Brief at p. 66-70. As described below, valuation actuaries are required, both by regulation and by the standards of

practice of the actuarial profession, to review data for reasonableness and consistency. However, actuaries typically are not trained or qualified as auditors and, in the absence of an extraordinary agreement with company management, valuation actuaries do not audit insurer data.

When a valuation actuary reaches an opinion on the adequacy of an insurer's reserves, the actuary bases that opinion on data provided by company management and certified by the company's auditors. Arizona's valuation law calls for the valuation actuary to review the data for reasonableness and consistency, but it does not require the actuary to audit the data. Indeed, the law specifically authorizes the valuation actuary to rely upon management for data. A.R.S. §20-696.04(A)(3)(c); A.R.S. §20-696.05(A)(3); *see also* §6(B)(5), National Association of Insurance Commissioners' Model Actuarial Opinion and Memorandum Regulation (providing sample language for use in actuarial opinions where the actuary relied upon management for data). Thus, the lower court erred to the extent it found that valuation actuaries are required by law to audit data.



#### **IV. Professional Standards Are Not Binding Prior to Their Adoption**

Appellants' Opening Brief raises questions concerning the applicability of Actuarial Standards of Practice issued by the Actuarial Standards Board<sup>6</sup> prior to the effective date of their adoption. *See* Appellants' Opening Brief at p. 62-64.

Each Actuarial Standard of Practice has a published effective date of three or more months after its adoption by the Actuarial Standards Board; until that time, an Actuarial Standard of Practice is not "applicable" and, therefore, is not binding upon actuaries under the *Code of Professional Conduct*. Each Actuarial Standard of Practice contains a description of current practices at the time it was developed. Actuarial Standards of Practice, therefore, can provide at least some evidence of what practice(s) were "generally accepted" by the actuarial profession prior to their development.

However, in some situations actuarial practice has not evolved to the point where a particular practice or practices have become "generally accepted" when a standard is adopted. In those situations, the Actuarial Standards Board is called

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<sup>6</sup> Actuarial Standards of Practice are promulgated by the Actuarial Standards Board to provide guidance to actuaries as they perform professional services on behalf of their clients and employers. The actuarial profession's *Code of Professional Conduct* specifically requires actuaries to ensure that their work complies with applicable Actuarial Standards of Practice.

upon to define what practice(s) will be generally accepted within the profession as it develops the Actuarial Standard of Practice. Where the Actuarial Standards Board either defines practice for the first time or, through the adoption of the standard, attempts to elevate practice beyond what would otherwise be generally accepted within the profession, the Actuarial Standards Board typically states that fact in the body of the standard. Such standards should not be deemed to reflect generally accepted practice prior to the date of their adoption.

Actuarial Standard of Practice No. 11, *The Treatment of Reinsurance Transactions in Life and Health Insurance Company Financial Statements* (“ASOP No. 11”), is an example of a standard developed in such a situation. ASOP No. 11 recognized that, prior to its development, “[p]ractices [with respect to the treatment of reinsurance transactions] have varied. The level of attention given to reinsurance transactions has ranged from perfunctory to detailed cash flow analysis. Some actuaries have considered only actuarial liabilities, and others have considered all statement assets and liabilities associated with the transactions.” ASOP No. 11, Section 4, “Current Practices.” The standard further observed that “very little guidance is currently available to actuaries in accounting for reinsurance, [therefore] it was widely believed that a standard of practice on this subject was necessary.” ASOP No. 11, Section 3, “Background and Historical

Issues.” Thus, no practice with respect to the treatment of reinsurance had become generally accepted at the time ASOP No. 11 was first proposed, and the lower court erred to the extent that it looked to ASOP No. 11 as evidence of generally accepted actuarial practice prior to its adoption.

## CONCLUSION

The Academy respectfully requests that the Court decide this appeal in a manner consistent with the arguments put forth herein.

Respectfully submitted,

American Academy of Actuaries

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Lauren M. Bloom, General Counsel  
and Director of Professionalism  
(admitted *pro hac vice*)  
American Academy of Actuaries  
1100 17th Street, N.W.  
7th Floor  
Washington, D.C. 20036  
(202) 223-8196

January 17, 2003

CERTIFICATE OF COMPLIANCE

Pursuant to ARCAP 16, I certify that the attached brief:

- Uses proportionately spaced type of 14 points or more, is double-spaced using a Times New Roman font and contains 3278 words; or
- Uses monospaced type of no more than 10.5 characters per inch; and
- Does not exceed twenty pages.

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Lauren M. Bloom

January 17, 2003