# Table of Contents

Preface ................................................................. ii

Background ........................................................... 1

What the Code of Professional Conduct Requires ................................. 2

Determining Qualifications .................................................. 3

Determining the Applicability of an Existing Standard of Practice .............. 4

Principles and Practices Generally Accepted By the Profession ................... 6

Guidance from Other Professions ........................................... 8

Professional Judgment .................................................... 9

Communications and Disclosures ............................................ 11
**PREFACE**

This discussion paper has been developed by the Committee on Professional Responsibility of the American Academy of Actuaries for discretionary use by actuaries. Its purpose is to assist actuaries in considering their obligation to comply with Precept 3 of the Code of Professional Conduct, which mandates that an actuary’s services be performed in a manner that satisfies applicable standards of practice. In instances where applicability is unclear or nonexistent, Annotation 3-2 of the Code provides that actuaries should exercise “professional judgment, taking into account generally accepted actuarial principles and practices.”

In addition, this discussion may be of some help to actuaries considering their obligation to comply with Precept 2 of the Code, which requires actuaries to be qualified to perform Actuarial Services. Annotation 2-2 explains that this requirement remains, even in the absence of applicable Qualification Standards.

This paper was not promulgated by the Actuarial Standards Board and is not binding upon any actuary. No affirmative obligation is intended to be imposed on any actuary by this paper, nor should such an obligation be inferred from any of the ideas expressed or suggestions made herein.

In considering and addressing the interests of the various parties who use their work products, actuaries should be guided by the Code of Professional Conduct. The Committee drafted this paper with no intention to add to, modify, or diminish the requirements of the Code. To the extent any conflict or difference appears to exist or could be implied between this paper and the Code of Professional Conduct, the Code would prevail.

Members are encouraged to share their comments on this paper with the Committee on Professional Responsibility to facilitate improvement in any future releases on this topic. Comments can be submitted to paper@actuary.org.

**JULY 2004**

The Committee on Professional Responsibility presents these ideas with the expectation that they will be both useful and thought-provoking and will provide a framework within which professional judgment can be applied in situations where no applicable standards of practice exist. 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 are intended to assist actuaries in applying the Code of Professional Conduct to their individual situations. The Committee believes that expanded discussion of the concepts and suggestions offered in this paper will benefit the profession.

**COMMITTEE ON PROFESSIONAL RESPONSIBILITY**

Thomas L. Bakos, Chairperson
Cara M. Blank     Carl Shalit
William C. Cutlip  Russel L. Sutter
Jeffrey L. Kucera  J. Kevin Watts
Robert E. Orean     Marc I. Whinston
BACKGROUND

Actuarial practice evolves over time, and actuaries may be called upon to provide professional services in new areas of practice or to perform tasks that were not previously needed. For example, changes in the financial services industry have offered actuaries the opportunity to become involved in asset management, investment oversight, and banking at a level beyond previous practice.

Actuarial Standards of Practice (ASOPs) are promulgated by the actuarial profession to provide its members with binding guidance on how to perform various types of professional services. Precept 3 of the American Academy of Actuaries’ Code of Professional Conduct (Code) requires members to ensure that professional services that are rendered by them or under their direction meet applicable ASOPs. Annotation 3-2 recognizes, however, that questions can arise with regard to the applicability of a standard of practice and that, in some instances, no applicable standard exists, and calls upon the actuary to utilize professional judgment in such cases, taking into account generally accepted actuarial principles and practices when determining how to perform professional services.

For practice in the United States, the applicable ASOPs are those promulgated by the Actuarial Standards Board (ASB) through a process of exposure of proposed standards and commentary by interested parties. In an effort to ensure that its standards provide actuaries with appropriate guidance, the ASB often issues multiple exposure drafts of proposed standards, and the development of an ASOP frequently takes a year or more. In the interim, practitioners may be called upon to provide requested professional services without the benefit of the guidance that an ASOP offers.

Further, not all ASOPs apply to every assignment an actuary undertakes. Most ASOPs are specific to a particular practice area or type of professional service. In the absence of an applicable ASOP, actuaries are expected to exercise professional judgment, taking into account practices generally accepted by the profession, in determining how to perform professional services.

In the past, actuaries have looked to Interpretative Opinion No. 4, Actuarial Principles and Practices, for guidance on practice in the absence of applicable ASOPs. However, when the Code was amended, effective January 1, 2001, many of the concepts previously set forth in Interpretative Opinion No. 4 were incorporated into the amended Code, and the Interpretative Opinion was withdrawn. The ASB issued an exposure draft of a proposed standard, Utilization of Generally Accepted Actuarial Principles and Practices, to replace Interpretative Opinion No. 4. Upon reviewing the comments received on the exposure draft, the ASB concluded that the Code offered sufficient appropriate guidance on most topics covered in the proposed standard and that it would be preferable not to issue any additional binding guidance in the form of an ASOP. However, the ASB believed that members might benefit from non-binding discussion of the various approaches practitioners take to their practice in the absence of an applicable ASOP. The ASB asked the Academy’s Council on Professionalism to develop a discussion paper on practice in the absence of applicable ASOPs. This paper responds to the ASB’s request.
**WHAT THE CODE OF PROFESSIONAL CONDUCT Requires**

The Code of Professional Conduct requires actuaries to adhere to the high standards of conduct, practice, and qualifications of the actuarial profession, thereby supporting the actuarial profession in fulfilling its collective responsibility to the public.

An actuary must be familiar and keep current with the Code of Professional Conduct and the applicable law and rules of professional conduct for the jurisdictions in which the actuary renders actuarial services.

Precept 3 of the Code requires that actuarial services that are performed by or under the direction of the actuary satisfy applicable Actuarial Standards of Practice. This implies that it is the professional responsibility of an Actuary to stay abreast of changes in these standards. Annotation 3-3 of Precept 3 states that when an actuary uses procedures that depart materially from those set forth in an applicable standard of practice, the actuary must be prepared to justify the use of such procedures. Moreover, Annotation 3-2 allows the actuary to utilize professional judgment in situations in which no standard exists or the applicability of existing standards is in question. In doing so, the actuary is reminded to take into account practices and principles generally recognized by the profession.

Critical decisions the actuary typically makes when working in a new or developing area are to what extent the actuary’s work in that area is subject to existing standards and to what extent existing practices and principles generally recognized by the profession can be applied, with or without adaptation. In making these decisions, the actuary takes into account the overall professional standards set by the Code.

Precept 1 requires an actuary 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. An actuary shall not engage in any conduct that involves dishonesty.

Precept 2 addresses competence more specifically, in stating that an actuary shall perform actuarial services only when the actuary is qualified to do so. To act honestly and with integrity is the foundation of the Code of Professional Conduct. There are fourteen precepts in the Code and each one is related to honesty and integrity. Precepts 4 through 14 apply honesty and integrity to communications and disclosures, confidentiality, conflicts of interest, professional courtesy and cooperation, advertising, ensuring that services are not used to mislead other parties, using titles and designations, and reporting and responding to violations of the Code of Professional Conduct.
DETERMINING QUALIFICATIONS

In determining whether he or she is qualified in a new or developing area, the actuary looks to Precept 2 of the Code and to the Qualification Standards (Qualification Standards) for Prescribed Statements of Actuarial Opinion (PSAOs). According to the Qualification Standards:

“Requirements to meet the General and Specific Qualification Standards are of three types:

• Basic Education: The actuary must have obtained sufficiently comprehensive knowledge of the subjects involved to be able to determine which actuarial concepts and techniques are applicable to the assignment, and to apply them successfully.

• Experience: The actuary must have experience relevant to the subject of the PSAO.

• Continuing Education: The actuary must obtain sufficient continuing education to maintain current knowledge of applicable standards and principles of practice in the actuarial practice area of the PSAO. The actuary must obtain an average of twelve credit hours per calendar year of continuing education at least 50% of which must consist of organized activities. Organized activities are formal activities that provide the opportunity to interact with other professionals.”

If the new or developing area of practice is one that is, at least, partly actuarial in nature, it is likely that the actuary taking on an assignment in that area satisfies the basic education requirement. That is, the actuary is usually able to determine which basic actuarial concepts and techniques are applicable to the actuary’s work in the evolving area.

With respect to the experience requirement, the current Qualifications Standards are focused on experience relevant to a particular PSAO, a document which is not likely to be required in an area that can be described as “new or developing.” However, Precept 2 of the Code does require that actuaries be qualified to perform the actuarial services they provide and, in particular, Annotation 2-2 emphasizes that this requirement to be qualified exists even if there are no applicable qualification standards.

In order to consider whether or not this experience requirement is satisfied, the experience of the actuary in one or more recognized practice areas that are, at least, partially applicable or related to the new or developing area could be considered. Actuarial concepts and techniques are often transferable or relevant in more than one practice area, and the possibility that there may be overlap can mean that experience in an established practice area can contribute to satisfaction of the experience requirement in a new or developing area.

As indicated, Continuing Education is a requirement that currently applies only to PSAOs.
DETERMINING THE APPLICABILITY OF AN EXISTING STANDARD OF PRACTICE

Some ASOPs, such as ASOP No. 41, *Actuarial Communications*, or ASOP No. 23, *Data Quality*, are applicable to virtually anything an actuary does, whether or not other ASOPs apply.

In determining which, if any, other ASOPs are applicable to a specific project in a new or developing area of practice, an actuary considers a number of factors. The actuary’s experience in the developing area of practice typically provides some insight as to whether any other ASOPs may apply. If the applicability of an existing ASOP, in whole or in part, cannot be determined by the actuary, then the actuary’s experience level may not be adequate to provide actuarial services in the developing area.

It is important to understand that, except in unusual situations, ASOPs are not like laws, regulations, or similar pronouncements that must be followed to the letter. ASOPs are the codification of practices generally accepted by the actuarial profession in traditional and well-recognized actuarial areas of practice. Most ASOPs have a provision that addresses divergence from their articulated requirements, subject to appropriate disclosure and possible justification. As opposed to diverging from a standard, an actuary working in a developing area might also consider the applicability of existing standards, at least in part, when searching for guidance regarding actuarial services provided in these new and developing areas of practice.

In general, the starting point for determining if an existing ASOP is, at least, partially applicable would be the actuary’s own knowledge and experience. An actuary working regularly in a particular area of practice and who is otherwise qualified usually will have sufficient knowledge and experience to know which, if any, ASOPs are applicable. If there are any significant doubts, the actuary may wish to take advantage of other qualified actuaries working in the practice area to gain their insight. Another excellent resource is the most recent Applicability Guidelines (available on the Academy’s Web site).

The ASB is constantly reviewing and, when necessary, revising ASOPs as actuarial practice changes or as a need for new standards develops. An actuary involved in a new and developing area can become aware of changes currently being considered by the ASB by reviewing proposed standards being distributed for comment that might address in whole or in part the new area of practice.

Requirements imposed by statute or regulation and rules created by courts or regulatory and quasi-regulatory boards such as the NAIC and the AICPA and similar bodies in the rest of the world can provide guidance in new and developing areas of practice. Examples of these include NAIC Model Regulation XXX (strengthening reserve requirements for term insurance) and SFAS 132 (modified FAS 87, 88, and 106). In fact, when requirements of law conflict with the Code, the requirements of law take precedence, although some actuaries choose to disclose such conflicts in appropriate actuarial communications. In the absence of clearly applicable ASOPs or Code precepts, the actuary may wish to consider whether applicable laws or regulations can provide some guidance on appropriate practice.

Actuaries may change their areas of practice and may not initially be fully qualified to practice in the new area. In these situations, the actuary would typically consult with an actuary qualified in the
new area in searching for applicable standards. Similarly, an actuary engaged in a new and developing area of practice may find that guidance with respect to possibly applicable standards, law, or regulation may be found by consulting with others more familiar with the area of practice or the particular assignment at hand. These other individuals may not be actuaries.

In general, in making an evaluation regarding the application of existing ASOPs or Code precepts, in whole or in part, the actuary utilizes professional judgment, taking into account principles and practices generally accepted by the actuarial profession.
PRINCIPLES AND PRACTICES GENERALLY ACCEPTED BY THE PROFESSION

Actuarial principles and practices are those derived from the professional actuarial literature or from common use by actuaries. To some extent, principles and practices generally accepted by the actuarial profession are codified in the profession’s ASOPs. However, practices not specifically described in the ASOPs can nevertheless be “generally accepted” to the extent that qualified members of the profession would agree that such practices are appropriate in a given situation.

Therefore, actuarial principles and practices consistent with practices described in the ASOPs as adopted by the ASB or otherwise established by other precedent or common usage can be considered generally accepted. Practices that are not consistent with practices described in the ASOPs or that are not established by other precedent or common usage typically cannot be considered “generally accepted,” even though such practices might yield an acceptable result in a given instance.

In the absence of an applicable ASOP, actuaries look to other sources in the actuarial literature for guidance on what principles and practices are generally accepted by the profession. Other sources of generally accepted actuarial principles and practices include the journals of recognized professional actuarial organizations (including the statements of principles promulgated by the Casualty Actuarial Society and the Society of Actuaries), recognized actuarial textbooks, study materials, and practice notes issued by the Academy. Some actuaries practicing in the United States also look to the published actuarial standards of practice of other countries, adapting them as necessary to U.S. practice. All of these materials are non-binding, but may provide the actuary with useful guidance in determining how to complete a particular assignment where no applicable ASOP exists. Actuaries’ companies may also have developed guidance on practice and procedures to be followed by actuaries employed by them.

Actuaries exercise professional judgment in determining the applicability and weight to be given to concepts described in the actuarial literature previously described. Actuaries may disagree as to the applicability of particular concepts or texts, and may legitimately prefer differing approaches or methods. It is not unusual or inappropriate for actuaries practicing in the absence of an applicable ASOP to rely on different sources within the actuarial literature, select different methods, or reach differing outcomes, and differences in outcomes do not necessarily indicate that one source or method is more appropriate than another.

Actuaries exercise professional judgment by examining particular assignments in light of known facts and anticipated circumstances. Typically, actuaries rely upon company management, accountants, auditors, and others professionals to provide the necessary data and other information and, when necessary, assumptions to support their analyses. Actuaries then select reasonable

---

1 Some actuarial work is governed by specific regulatory requirements or must follow methods and procedures established outside the actuarial profession, such as generally accepted accounting principles. Actuaries typically comply with such requirements to the extent they are applicable without regard to whether such requirements are consistent with ASOPs or principles and practices generally accepted by the actuarial profession. However, in such instances, ASOPs often call for the actuary to disclose the requirements with which the actuary’s work complies. ASOP No. 41, Actuarial Communications, provides guidance in this regard. If they believe that such requirements conflict with ASOPs or principles and practices generally accepted by the actuarial profession, some actuaries also choose to disclose the conflict in an appropriate communication.
assumptions and appropriate methods based on their professional training and experience and their understanding of appropriate practice under the circumstances. Actuaries can legitimately disagree in their selection of assumptions and methods, and more than one method or assumption may be appropriate in a particular situation.

The ABCD can be an excellent source for advice on principles and practices generally accepted by the profession. When the ABCD is unable to provide specific guidance relative to a particular situation or project, it may be able to refer the actuary to other resources for guidance both inside and outside the profession.
GUIDANCE FROM OTHER PROFESSIONS

A standard may not exist for a particular activity undertaken by an actuary because the activity is in an area of practice in which actuaries are not traditionally or typically involved. To the extent that such areas of actuarial activity overlap with the activities of other professions, the standards, procedures, or practices generally accepted by these other professions may provide guidance or be applied or adapted to the actuary’s work.

For example, actuaries who participate in the preparation of financial statements that are subject to the application of generally accepted accounting principles and standards produced by non-actuarial standard-setting bodies generally look to the principles, standards, and literature of the accounting profession as a source of useful guidance.

Actuaries may also find it useful to be aware of generally accepted principles and practices of other professions as the domain of their work or their employers’ involvement in new areas of work generates new overlapping areas of practice. Attorneys, economists, financial engineers, and mathematicians all work in areas that may overlap with the work of an actuary. Actuaries are not bound to conform to principles or practices of these other professions but may find them to be helpful sources of information or ideas.
PROFESSIONAL JUDGMENT

Professional judgment relates to the decisions made by an actuary while providing actuarial services. Professional judgment is reflected in the recommendations, advice, findings, or opinions that are the expression of the actuarial service provided.

In a broad sense, actuaries typically make the judgments or decisions incorporated into the actuarial services they provide based on the following important elements:

- appropriate application of the Code;
- applicable standards;
- their education;
- their prior experience;
- investigative research; and
- analysis.

The Code anticipates, in Annotation 3-2, that the actuary may be involved in an area in which no applicable standard exists. In this situation, the Code advises the actuary “to utilize professional judgment.” In this narrower sense, then, an actuary’s professional judgment can only rely on the listed elements noted above exclusive of applicable standards.

The absence of applicable standards for an area or areas of actuarial practice may imply that the area or areas of practice are too new for generally accepted practices to have developed. In this situation, the application of professional judgment by any actuary providing service in this area will add to a collective base of experience from which generally accepted practices might emerge and, ultimately, an ASOP might be developed in the future.

ASOPs may also not exist for particular areas of practice or activity because standards were not considered necessary for those areas of practice by the ASB. An ASOP may not have been considered necessary, for example, if the reasonable options available to an actuary providing an actuarial service related to an activity are so numerous as to defy the need for enumeration or specificity. In this situation, professional judgment, exclusive of a standard, is the expected and anticipated basis for the actuary’s decisions related to the service provided.

ASOPs, when they do exist, provide actuaries with a basis for believing that their work product conforms to principles and practices generally accepted by the actuarial profession as evidenced by the exercise of the professional judgment of the qualified actuaries whose practice contributed to the ASOP. By virtue of being an example of accepted principles and practices, ASOPs can also provide education in practice areas in which an actuary may be unfamiliar. This suggests that, in the exercise of professional judgment in the absence of a standard, an actuary may wish to keep in mind (in addition to satisfying the other important elements of professional judgment noted above) the following:

Application of Principles • July 2004
• the contribution the actuary’s exercise of professional judgment might have on a future standard; and

• the educative value of the approaches, techniques, or processes utilized in the exercise of professional judgment.

The above implies that, in the exercise of professional judgment, actuaries apply their knowledge with integrity, informed judgment, and perspective with respect to the circumstances of the specific situation and the intended purpose of the results of the actuaries work product.

With respect to the application of the important elements enumerated above in the professional judgments or decisions that actuaries make, the following sources of data may be considered:

• applicable ASOPs or practices and principles generally accepted by other actuarial organizations (e.g., in a different practice area or foreign);

• information contained in articles published in recognized actuarial journals;

• information contained in recognized actuarial text books;

• relevant study materials produced by recognized actuarial organizations; or

• practice notes published by the Academy.

The actuary is usually prudent to bear in mind that professional judgment is a part of decisions the actuary makes whether made in the presence of an ASOP or not.
COMMUNICATIONS AND DISCLOSURES

Whenever the actuary provides professional services, the obligation to adhere to the Code of Professional Conduct applies. In particular, Precepts 4 through 6 of the Code, which deal with Communications and Disclosures, address a general requirement that applies to all actuarial services regardless of whether or not more specific ASOPs exist.

In addition, with respect to communication and disclosure of actuarial opinions, findings, and conclusions, ASOP No. 41, Actuarial Communications, will apply. ASOP No. 41 requires the actuary, when preparing an Actuarial Report, to “identify the data, assumptions, and methods used by the actuary with sufficient clarity that another actuary qualified in the same practice area could make an objective appraisal of the reasonableness of the actuary’s work as presented in the actuary’s report.” This requirement pertains whether or not more specific guidance on communications exists in other applicable ASOPs.

When ASOPs do exist, they usually contain within them a section that requires the actuary to disclose any deviation from the stated standard and provide a statement with respect to the nature, rationale, and effect of the deviation. When providing an Actuarial Report or other communication with respect to work not covered by an ASOP, the actuary may find it helpful to state, at least, that no applicable ASOP exists that addresses the substance of the work performed. By making such a statement, it becomes clear that the actuary’s work did not deviate from the requirements of an ASOP.

It is likely, when doing work in an area in which no standards exist, that an actuary would have applied some combination of principles and practices generally accepted by the actuarial profession, parts of existing standards that might relate to the work being done, standards from other professions, or other rules, methods, or processes adopted specifically for the project. It is usually helpful for the actuary to state in any report prepared as a consequence of the actuary’s work which of these sources were relied upon and any material deviations from them that might have been made.