

Projections, Not Predictions

ACTUARIES MAKE FINANCIAL ESTIMATES as an integral part of providing professional services to their principals and employers. There are good reasons people hire actuaries to make these estimates:

- Actuaries are trained in the mathematics of estimating the financial implications of possible future events and understand the relevant statistics and business considerations in making these estimates.
- Actuaries use an extensive literature concerning projections to supplement their own personal knowledge.
- Actuaries are accepted in the financial world as experts in making these estimates.

erty/casualty (P/C) insurance companies go insolvent due to deficiencies in loss reserves.

Regulatory confidence in actuaries has been sufficiently high

to expand the situations in which an actuary has been called upon in law or regulation to provide a professional opinion. For example, laws and regulations requiring each insurer to submit an actuarial opinion on the adequacy of loss reserves as part of its annual report have been put in place as part of the National Association of Insurance Commissioners' solvency effort.

At first glance, it appears that we have reached actuarial nirvana—lots of work, great value placed on actuarial estimates, and good pay. However, this desirable position may unravel because:

- There are more and more lawsuits and threatened lawsuits against actuaries.
- These lawsuits are usually for enormous amounts of money relative to the fees received for the estimates.
- Plaintiffs bring lawsuits even where there is little or no connection between a financial problem and the actuarial estimate.

The most significant influence is the enormous size of the damages sought relative to the fees for doing the work. Consider an example from the P/C world. I've seen many situations in which the fee for a loss reserve opinion is \$50,000 or less and the loss reserve estimate is about \$100 million or more. A reasonable range around the reserves may be as much as \$10 million or more. And it's possible that variation can be

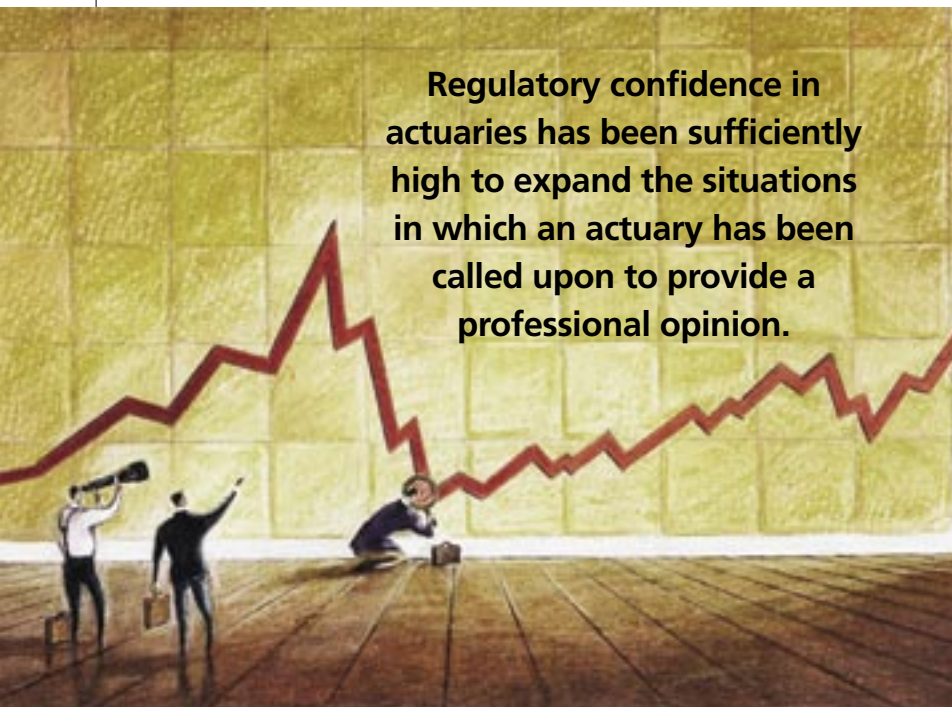
\$25 million or more for highly volatile lines.

In this type of case, an alleged error in the loss reserve estimate could lead to a claim for damages in excess of \$15 million. Now that actuaries have come to the attention of plaintiff lawyers, liquidation bureaus, and other possible plaintiffs when an insolvency or failed merger occurs, the actuary is generally named as one of the defendants.

What are the consequences of today's situation? We see:

- An increasing number of actuaries are refusing this type of work because of the liability exposure associ-

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So far, the actuarial profession has done an admirable job in estimating the likely costs of future contingent events. Most pension plans remain solvent if fully funded, sufficient funds are almost always available to pay off life and health obligations, and fewer than 1 percent of prop-

CHARLES A. BRYAN is president of CAB Consulting Services in Columbus, Ohio. He is a member of the Professional Liability Prevention Task Force and was president of the American Academy of Actuaries in 1994-95.

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ated with these types of assignments.

- Actuaries are seeking actuarial liability insurance with high limits. Except for the large firms, liability limits available usually are only, at most, \$5 million. Because of the large damages alleged in suits against actuaries, an amount of \$5 million frequently doesn't offer adequate protection.
- Actuarial firms are usually organized as limited liability corporations. This organization offers some protection but may not be solid enough to risk all of the actuary's personal assets on each assignment.

Given that plaintiffs' attorneys and liquidation bureaus won't become sym-

pathetic to the plight of the actuaries, the profession is exploring ways to draw a proper balance between the need to hold professionals accountable for their work and the need to define an appropriate standard of fair liability so that it's possible for actuaries to perform their work without unreasonable exposure to frivolous lawsuits.

One area that holds some promise is to provide protection for actuaries that is similar to the protection for accountants under the Private Securities Litigation Reform Act. This act provides a safe harbor for forward-looking financial statements. The reform act provides, in general, that an accountant will not be liable in a se-

curities fraud action if:

- The forward-looking statement is identified as such and is accompanied by cautionary statements; or
- The statement is not material; or
- The plaintiff fails to prove that the forward-looking statement (a) if made by a person, was made with actual knowledge by that person that the statement was false or misleading or (b) if made by a business entity, was made by or with the approval of an executive officer and was made or approved by such officer with actual knowledge that the statement was false or misleading.

Actuarial estimates are usually very similar to forward-looking financial statements in that they're an estimate of what may happen in the future, not a guarantee of any future outcome, and the accuracy of the estimate depends on numerous external factors. In fact, the cautionary wording often used in forward-looking financial statements would serve equally well as cautionary wording for actuarial estimates. Sample wording from the accounting profession might be:

"Financial statements contain forward-looking statements. These statements are subject to a number of risks and uncertainties, and actual results and events could differ materially from those currently being anticipated as reflected in such forward-looking statements. Factors that may cause future outcomes to differ from those foreseen in forward-looking statements include, but are not limited to, general economic conditions and business conditions, changes in law and legal interpretation, and the impact of technological change."

Accountants are provided these protections, and it is in the public interest for the same reasons to provide actuaries these protections for actuarial estimates that are forward looking by their nature. ●

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