PROFESSIONAL LIABILITY

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1. INTRODUCTION

1.1 As society becomes more concerned with consumer protection and related concepts, professionals are becoming increasingly accountable to their clients for the quality of services they provide. No longer is the practice of a professional subject only to the scrutiny of his peers or his professional association. The actuarial profession is not unique in this regard. Litigation against members of the actuarial profession has been extremely rare. Nevertheless, members of our profession should recognize that the general trend is in the direction of increased litigation against professionals.

1.2 Professional liability has been a topic for discussion by the actuarial profession in recent years. This paper has its origins in work carried out over the last 3 years by the Committee on Legal Liability of the Canadian Institute of Actuaries. These origins have largely determined the content of the paper. The author wishes to acknowledge the assistance which he has received from the members of the Committee on Legal Liability.

2. BACKGROUND

Standard of Care

2.1 The standard of care of the professional person has its foundations in ancient Roman law which established the standard of care for medical practitioners and others as a duty to act with "professional skill", and the failure to exercise that skill by one holding himself as possessing professional skill amounts to negligence. In English law it seems well settled that the standard of care in a certain field is that commonly observed by the reasonable, competent and diligent professional man within that field.

2.2 The specialist in any profession is expected to perform at a higher level than the general practitioner. A higher degree of skill is required. The courts have not lowered the standard of care for the inexperienced practitioner in a particular field, but have imposed the same standard of care as might be expected from the average practitioner in that field.

Legal Liability

2.3 The legal liability of a professional to his client arises from the contract between them. The mere act of consulting a professional in his professional capacity creates a contract. The contract does not necessarily have to be in writing.

2.4 To establish legal liability, the plaintiff would have to prove negligence on the part of the defendant. If the professional man is in some doubt about his course of action, due to reason of his inexperience or otherwise, he would be advised to obtain the opinion of a specialist in the field before proceeding further and his failure to do so might well constitute negligence.

2.5 Various court cases have opened up the possibility of claims by persons beyond those immediately involved in the contract. The third party would have to demonstrate not only that there had been negligence on the part of the professional but also that the plaintiff relied upon the professional and as a result suffered damages. The principle of protection of third parties is being recognized more and more by the courts in individual case decisions and is starting to appear in legislation. A notable example is the ERISA legislation in the United States which places certain obligations on the actuary to act on behalf of plan participants.

Damages and Costs

2.6 The measure of damages is that as a general rule damages must be awarded to the plaintiff in an amount to put him in the same position so far as it is monetarily possible as if he had not suffered the damage.

2.7 Under some judicial systems, the successful litigant can expect in normal circumstances to be awarded by the Court his "party and party" expenses. These costs do not amount to a complete indemnity, but nevertheless they can be quite substantial.

2.8 Other factors which can affect the size of settlement include:

- contingency fee arrangements by lawyers
- trial by jury
- "pain and suffering" and "punitive" damages.

2.9 In addition, the amount of time that the professional and his staff has to devote to a case can be tremendous. There is a great deal of stress placed on the professionals immediately concerned together with the knowledge that they might well be disciplined by the professional body for the same error or omission once the civil proceedings are done.

3. RISKS FACED BY ACTUARIES AND THEIR EMPLOYERS

Degree of Risk

3.1 For the individual actuary, the capacity in which he works is a major determinant of his exposure to legal liability. The exposure of the insurance company employee, the government employee, the industrial company employee, or the teacher is relatively minor in connection with their daily work. However, should such an employed actuary undertake spare-time consulting work he will be exposed to legal liability. There is a much more significant exposure for those actuaries consulting in public practice since they are specifically holding themselves out to the public as experts in their field and the public is without proper ability to judge their competence prior to engaging them.

3.2 In general, a litigant is more likely to bring an action against the employer than against its actuary primarily because of the employer's much greater ability to pay damages.

Areas of Liability Exposure

3.3 The major areas of personal liability exposure are:

(a) Arithmetical mistakes.
(b) Errors in judgement.
(c) Failure to ensure accuracy of data upon which actuarial calculations are based.
(d) Providing inaccurate or incomplete advice on specific problems.

Examples

3.4 Some examples of potential risk are highlighted below.

3.4.1 **Insurance**

(a) Demonstrated incompetence in the determination of premium rates and reserves resulting in financial loss.
(b) Certification of annual statements.
(c) Actuarial services provided under pension plans administered by an insurance company.
(d) Advice given in connection with insurance company mergers.

3.4.2 **Employee Benefits**

(a) Incompetent or inattentive work in the design of employee benefit plans.
(b) Arithmetical mistakes, data errors, employment of unreasonable assumptions affecting the size of surplus or deficit.
(c) Errors in pension text or employee booklet.
(d) Errors in computation of individual benefit calculations.
(e) Advice provided by an actuary to a regulatory authority regarding the approval of a pension valuation report.
(f) Approximate answers, especially arising in the pressure of union negotiations.
(g) Allocation of fund assets and benefits in the event of plan termination.
(h) Determination of plan liabilities and allocation of assets in the event of a split-up or spin-off of a part of a pension plan.
(i) Advice given on the actuarial position of a pension plan of a company in connection with a merger.

3.4.3 **Other**

(a) Differences in actuarial opinion on such matters as pensions plan solvency, transfer of pension plan reserves, valuation of insurance company stock.
(b) Expansion of services into new fields.
(c) Misinterpretation of documents or misunderstanding of instructions given by client.
(d) Misunderstanding by client resulting from inadequate explanation by actuary.
(e) Isolating a potential problem, but ignoring it for one reason or another.

The foregoing is not intended to be an exhaustive list but is merely an indication of some types of risk.

3.5 It should be noted that an actuary or his employer may be subject to legal liability arising out of the actions of an associated or correspondent firm working for his client. These relationships should be examined carefully to ensure that the proper standard of care is being followed.

4. RISKS FACED BY PROFESSIONAL BODY

4.1 The professional body itself is exposed to the risk of legal liability. This arises because the professional body is responsible for the training and standards of competence of its members, and also the regulation and discipline of members.

4.2 Some examples of the risks facing a professional body include:

- actions arising from failure to enforce rules of conduct, or, alternatively, too strict an enforcement.
- failure to promote high standards of competence.
- actions from individuals excluded from membership.
- inadequate screening of material published by or on behalf of the professional body.

4.3 The risk of legal liability covers not only the professional body but also any person acting on its behalf, e.g. officer, members of Council, members of committees, etc.

5. DEFENCE AGAINST LEGAL LIABILITY

5.1 The best defence against legal liability is to ensure that the professional work carried out is of the highest professional calibre. Top quality work involves continuing self-education on the part of the professional.

5.2 The following are some actions that an actuary or his employer might take to reduce the risk of legal liability:

(a) An actuary should ensure that the terms of reference of any assignment and of any changes in such terms are carefully documented.
(b) When an actuary is invited to provide services to a principal who had previously used the services of another actuary, enquiry should be made as to whether the other actuary is aware of any professional difficulties which might arise from such an invitaion.
(c) Any actuary should not undertake assignments unless he has, or is prepared to obtain, the necessary level of competence either before or as part of the assignment. An actuary should prudently take counsel of others in respect of matters on which he is not an expert.
(d) Care should be taken in checking calculations, testing computer programs, transcribing results. A senior person should be responsible for each assignment and in the case of a complex assignment more than one professional could be assigned to each client to ensure quality control and independent review of results. Additional levels of peer review may be appropriate. Peer review is essential not only to avoid professional

liability but also to provide the finest professional advice possible.

(e) Care should be taken in requesting and examining data for calculations to ensure data is correct and that it represents what it ought to represent.

(f) All oral opinions or answers should be confirmed in writing.

(g) All documents prepared by an actuary which might be construed as a legal document should be reviewed by a lawyer, preferably the client's own legal firm.

(h) Special attention should be given to the wording of any statements of opinion. The facts upon which the opinion are based should be clearly enunciated.

(i) It would be prudent for an actuary to seek a legal opinion regarding the interpretation of a document where there is room for doubt.

(j) Continuing self-education is important in keeping abreast of current developments.

5.3 Some of the actions which the professional body might consider taking include:

(a) The publication of guides to help actuaries handle certain situations that have a high risk of legal liability.

(b) Making qualification as an actuary contingent on a minimum period of experience.

(c) Ensuring that a high standard of screening of all material published by or on behalf of the professional body is maintained.

(d) Continuing to expand the scope and level of educational activities within the professional body.

6. INSURANCE

6.1 A claim for damages and costs can be substantial. Indeed, an uninsured claim settled against an actuary, either in or out of court, could literally destroy all his years of effort. All his assets could be forfeited and part of his future earnings might be taken in settlement of a claim. Even if an action for damages fails, the innocent party may have to meet the expenses of his defence.

6.2 However hard one tries, mistakes can happen and therefore insurance coverage becomes an essential part of the cost of the practice of an actuary. There are two different bases under which professional liability insurance is written:

(a) The "occurence" basis.

(b) The "claims made" basis.

6.2.1 The "occurrence" type of coverage is intended to protect the insured for claims made during or after the policy period arising out of errors occurring during the policy period only. The advantage to the insured is that if he retires, ceases practice or no longer purchases insurance, he will be protected against claims for his past work. Many insurers in this field have severely restricted or even curtailed their underwriting of this type of coverage because some claims may take several years to settle and the amount of claim paid would be settled at inflated costs and values applicable in the year of settlement, whereas the premium for this coverage would be charged in current currency.

6.2.2. The "claims made" type of coverage only covers claims against the policy in force at the time the claim is presented. The insured may have committed the error at any time in the past but provided he is completely unaware of any possible liability or claim circumstance then the policy will protect him. The insured should consider whether any special protection is required in the event he retires or ceases practice in order to have a "run off" of cover for all his past work.

6.2.3. Changing from a "claims made" to an "occurrence" type of policy is not advisable since claims would be uninsured for acts prior to the start of the new policy. Similarly, a change from one insurer to another on a "claims made" basis poses problems in that the old insurer will not cover claims arising after the policy expires, and the new insurer will not cover any risk where the insured had knowledge prior to the changeover.

6.3 The type and amount of professional liability coverage will depend on size of insured firm. A prudent guideline is to purchase the maximum coverage available, or economically affordable in the case of small firms. If it is decided the maximum is not required, the coverage could be geared to the worst possible risk facing the insured. Another guide is the size of clientele by fee and the spread of clients i.e. does the business depend on a few clients who develop a large percentage of fee income? Deductibles vary from case to case but are normally required by insurers to control claims. Where the premium is high, a small firm could consider maximizing coverage at approximately the same cost by possibly increasing the deductible. It may be possible to arrange substantial limits of coverage by arranging coverage with more than one insurer on a "layered" basis.

6.4 A major problem is to find appropriate insurance. Actuaries are often placed in the same risk group as accountants, yet our experience is much more favourable. In addition, insurers have been withdrawing from the market because of bad experience with professional liability coverage in general. There are just a handful of markets available for this type of insurance.

6.5 As an alternative to each firm obtaining its own insurance, what could be considered is an insurance scheme sponsored by the professional body for its members. There are two main advantages to this sponsored coverage. Firstly, it should be possible to obtain coverage at a lower cost than would be charged to individual firms. Secondly, it would be possible for the professional body to monitor significant trends relating to causes of losses, types of claims and other matters of importance so as to provide a basis for the professional body to consider broad educational and loss prevention measures.

This raises the question as to whether such coverage should be voluntary or compulsory. Certain professions in Canada, for example, have set up universal, compulsory schemes for their members in public practice. On the whole, though, professions which have sponsored insurance schemes have tended to make them voluntary. This may result in lower participation than would otherwise be the case but it would avoid conflict with existing schemes. On the other hand, if the aim of the professional body is to ensure adequate coverage of its members in public practice, this can hardly be done through a voluntary scheme.

6.6 Yet another alternative, if membership is sufficiently large, is whether there is some merit in a certain degree of self-insurance for members of the professional body. It would be possible to set up a fund for settlement of damages up to a certain level. Beyond this, an insured scheme could cover excess claims. Such a scheme would enable the professional body to monitor mistakes and settle most claims, and would also enable the professional body to take effective steps to prevent the recurrence of mistakes. This partial self-insured approach has been adopted, for example, by the Law Society of Upper Canada.

Some observers argue that this approach towards professional liability insurance offers the only help left to professionals when insurance coverage through conventional channels is either extraordinarily expensive or simply not available. However, there are difficulties associated with this approach in that with the relative small size of our profession a number of serious claims could quickly exhaust any fund and then it would be necessary to impose an additional assessment on members. Most firms might prefer to take out insurance protection with the assurance that they would not be subject to a reassessment in the event of any unexpected unfavourable experience.

6.7 Although not an insurance arrangement, employees of a firm can be protected by means of a Company By-law.

7. CONCLUSION

7.1 Litigation against members of the actuariral profession has been extremely rare. Nevertheless, we should recognize that the general trend is in the direction of increased litigation against professionals.

7.2 However hard one tries, mistakes can happen and therefore it is important to ensure that one has proper protection. The purpose of this paper is to highlight potential legal liabilities and to suggest some possible safeguards.

7.3 The best defence against legal liability is to ensure that the professional work carried out is of the highest professional calibre. This requires the careful delegation of responsibilities, quality control checks, and peer review. Beyond this, insurance coverage becomes advisable to cover situations that may materialize in spite of our best efforts to avoid them.

7.4 While the public has the right to be protected from the incompetent and the careless, the fear of being found liable should not be so great as to reduce the professional's ability to exercise his judgement and act in a manner that may ultimately be in the best interests of the public.