

# EUMAEUS DISCUSSION PAPER 2102

## Actuarial Standards

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The IFoA have a fair amount of material on their website about actuarial standards and regulation. Here are some quotes from their website (but the italics are ours):

<https://www.actuaries.org.uk/about-us>

*"Under our Royal Charter we have a duty to put the public interest first"*

<https://www.actuaries.org.uk/about-us/our-brand>

*"Our vision is for the Institute and Faculty of Actuaries (IFoA) to serve the public by ensuring that where there is uncertainty of future outcomes, actuaries are trusted and sought after for their valued analysis and authority"*

"Integrity

- We are: *Doing the right thing* for the organisation, our members, the profession *and the public interest*
- By being:
  - Honest
  - Accountable, and
  - Professional."

<https://www.actuaries.org.uk/upholding-standards/standards-and-guidance/actuaries-code>

*"The Actuaries' Code is the ethical Code of Conduct that all Members of the IFoA must adhere to. It came into force on 18 May 2019.*

The Code has six principles.

1. Integrity – Members must act honestly and with integrity.
2. Competence and care – Members must carry out work competently and with care.
3. Impartiality – Members must ensure that their professional judgement is not compromised, and cannot reasonably be seen to be compromised, by bias, conflict of interest, or the undue influence of others.
4. Compliance – Members must comply with all relevant legal, regulatory and professional requirements.
5. Speaking up - Members should speak up if they believe, or have reasonable cause to believe, that a course of action is unethical or is unlawful.
6. Communication – Members must communicate appropriately."

On point 2, given the problems entailed by the DP approach (including, e.g., that it produces not inconsiderable NNEG under-valuations) the question is whether/how it meets the requirement of "competently and with care."

On point 3, there is the issue of whether it is appropriate to prefer one approach over another because of commercial considerations.

The exam question is this. Explain how the DP approach: (a) is compliant with the 'duty to put the public interest first;' (b) is 'doing the right thing;' (c) involves work that is carried out 'competently and with care;' and (d) is compliant with 'all relevant legal, regulatory and professional requirements.'

Answers to be sent to: Putting Things Right, Office of the Chief Executive, Institute and Faculty of Actuaries, Holborn Gate - 7 th Floor, 326-330 High Holborn, London WC1V 7PP.

The full text of the Actuaries' Code is [here](#).

## **Integrity**

On the question of honesty, there is also a legal standard namely, what any ordinary person would reasonably regard as dishonest. Lord Lane CJ set out the well known 'Ghosh Test' or *two limb approach* to the issue of dishonesty in R v Ghosh 1982. The test is (i) whether according to the ordinary standards of reasonable and honest people what was done was dishonest, and (ii) If so, did the defendant realise that what was done was *by those standards* dishonest.

Justice Cooke applied the test in the well-known case against Tom Hayes, the trader who was convicted for the manipulation of LIBOR.<sup>1</sup> Cooke ruled that the standard for dishonesty is absolute, and cannot change by reference to market standards or market ethos, standard practice in an industry or any common understanding amongst employees.

There is no authority for the proposition that objective standards of honesty are to be set by a market. Quite the contrary:

The history of the markets have shown that, from time to time, markets adopt patterns of behaviour which are dishonest by the standards of honest and reasonable people; in such cases, the market has simply abandoned ordinary standards of honesty. Each of the members of this court has seen such cases and the damage caused when a market determines its own standards of honesty in this way. Therefore to depart from the view that standards of honesty are determined by the standards of ordinary reasonable and honest people is not only unsupported by authority, but would undermine the maintenance of ordinary standards of honesty and integrity that are essential to the conduct of business and markets.

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<sup>1</sup> [https://www.judiciary.gov.uk/wp-content/uploads/2015/12/r\\_-v\\_tom\\_alexander\\_william\\_hayes\\_redacted\\_approved.pdf](https://www.judiciary.gov.uk/wp-content/uploads/2015/12/r_-v_tom_alexander_william_hayes_redacted_approved.pdf)

## **Impartiality**

*“3. Members must ensure that their professional judgement is not compromised, and cannot reasonably be seen to be compromised, by bias, conflict of interest, or the undue influence of others.*

3.1 Members must take reasonable steps to ensure that they are aware of any relevant interests that might create a conflict.

3.2 Members must not act where there is an unreconciled conflict of interest.”

On point 3, there is an interesting quote in the industry manual on NNEG valuation, Hosty *et alia* (2007): “For providers attempting to price the NNEG on a market consistent basis there is insufficient product margin in order to provide a competitive product ...” (p. 30.). Section 7.3.3 of that manual also explains that under a market consistent approach the product would not be profitable, whilst the discounted projection (aka real world) model “has produced a significantly lower cost” and is therefore to be preferred.

## **Speaking up**

*“5. Members should speak up if they believe, or have reasonable cause to believe, that a course of action is unethical or is unlawful.*

5.1 Members should *challenge others on their non-compliance with relevant legal, regulatory and professional requirements.*

5.2 Members must report to the Institute and Faculty of Actuaries, as soon as reasonably possible, any matter which appears to constitute Misconduct for the purposes of the Disciplinary and Capacity for Membership Schemes of the Institute and Faculty of Actuaries and/or a material breach of any relevant legal, regulatory or professional requirements by one of its Members.

5.3 In addition to complying with any legal requirements to report matters to relevant regulators or other authorities, Members should also report to those bodies any behaviour that they have reasonable cause to believe is unethical or unlawful, and carries significant risk of materially affecting outcomes.

5.4 Members must take reasonable steps to ensure users are aware of any substantial issues with a piece of work for which they are responsible or in which they have had significant involvement, if those issues might reasonably influence the decision-making or judgement of users.”

Actuarial standards are summarised in the following four documents, from which we reproduce key passages.

The first is APS X1:

### **APS X1: Applying Standards to Actuarial Work<sup>2</sup>**

*“8.2. Members must be able to justify the standards applied (and/or not applied) to their Actuarial Work, if reasonably called upon to do so.*

*9.1. A failure to comply with this APS may result in a finding of misconduct in terms of the IFoA’s Disciplinary Scheme.”*

### **APS X2: Review of Actuarial Work<sup>3</sup>**

The second is APS X2, which applies to the review of actuarial work, and which is relevant to the IFoA/ABI working party’s work on NNEG valuation:

*“1.3. In considering for the purposes of paragraphs 1.1 and 1.2 whether and to what extent Work Review should be applied to a piece of work (including whether and to what extent Work Review should be in the form of Independent Peer Review), Members should have regard to all of the relevant circumstances, including the following:*

*1.3.1. the degree of difficulty of the piece of work and its complexity*

*1.3.2. the significance of the piece of work, including any financial, reputational or other consequences for the person(s) for whom the work is produced”*

The words “reputational or other consequences” jump out a bit.

*“1.3.3. whether the circumstances of the piece of work make it more likely that errors could be made”*

Yes, it is possible that an approach that can produce impossible valuations could produce errors.

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<sup>2</sup> <https://www.actuaries.org.uk/documents/aps-x1-applying-standards-actuarial-work>

<sup>3</sup> <https://www.actuaries.org.uk/documents/aps-x2-review-actuarial-work>

“1.3.4. the reasonable expectations of the person(s) for whom the work is produced;

1.3.5. the extent to which judgement and/or analysis is required

1.3.6. *the application of other quality assurance controls to the piece of work;*”

We have tried and tried to elicit information – hard information, as opposed to boilerplate waffle – about the quality assurance processes used by the IFoA/ABI working party’s on NNEG valuation, but no-one in any position of responsibility will take responsibility, even in private, let alone in public. What was the independent scrutiny process, who were the senior figures in the IFoA or Actuarial Research Council who signed off, etc? So as regards the quality assurance in this case, we can’t work out what it was and no-one in the know will tell us.

“1.3.7. *the desirability of assuring public confidence in the quality of the work in question.*”

The question is how failing to answer concrete questions about the quality assurance process helps to assure public confidence in the quality of the work in question.

#### **Technical Actuarial Standard 100: Principles for Technical Actuarial Work, Financial Reporting Council December 2016.<sup>4</sup>**

“Technical Actuarial Standard 100: Principles for Technical Actuarial Work (TAS 100) promotes high quality technical actuarial work. *It supports the Reliability Objective that users for whom actuarial information is created should be able to place a high degree of reliance on that information’s relevance, transparency of assumptions, completeness and comprehensibility, including the communication of any uncertainty inherent in the information.*”

The question is how users can place “a high degree of reliance” on valuations produced by an approach that can produce impossible valuations.

“1. *Judgement shall be exercised in a reasoned and justifiable manner; material judgements shall be communicated to users so that they are able to make informed decisions* understanding the matters relevant to the actuarial information.”

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<sup>4</sup> <https://www.frc.org.uk/getattachment/b8d05ac7-2953-4248-90ae-685f9bcd95bd/TAS-100-Principles-for-Technical-Actuarial-Work-Dec-2016.pdf>

The task is to explain what is “reasoned and justifiable” about the DP approach and to explain in what sense are decisions based on an approach that can produce impossible valuations to be considered “informed,” e.g., as opposed to the opposite.

*“2. Data used in technical actuarial work shall be appropriate for the purpose of that work so that users can rely on the resulting actuarial information.”*

“appropriate”, “rely” ...

*“2.1 Data shall be relevant for the purpose of the technical actuarial work.”*

Actuaries are using assumptions about *hpi* to price the forward in their NNEG valuation models, but we have explained earlier that *hpi* is irrelevant.<sup>5</sup> So in what sense is an irrelevant variable relevant?

*“3. Assumptions used, or proposed for use, in technical actuarial work shall be appropriate for the purpose of that work so that users can rely on the resulting actuarial information.”*

How can it be appropriate to use an incorrect approach that depends on an irrelevant variable? And how are results based on an inappropriate assumption about an irrelevant variable reliable for users?

### **“Technical Actuarial Standard 200: Insurance,” Financial Reporting Council December 2016<sup>6</sup>**

The fourth is TAS 200, which applies to insurance.

*“8. Measures, assumptions and judgements used to derive any estimates described as “best estimate”, “central estimate” or other similar terms shall be neither optimistic nor pessimistic and shall not contain adjustments to reflect a desired outcome.”*

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<sup>5</sup> See also, e.g., PRA SS 3/17 (p13, para 3.17) which states: “It is important to note that views on future property growth play no role in preferring one contract over the other. Investors in both contracts will receive the benefit of future property growth (or suffer any property depreciation) because they will own the property at the end of the deferment period. Hence expectations of future property growth are *irrelevant* ...” (our emphasis)

<sup>6</sup> <https://www.frc.org.uk/getattachment/c866b1f4-688d-4d0a-9527-64cb8b1e8624/TAS-200-Insurance-Dec-2016.pdf>

Heaven forbid that anyone might want to push deferment rates down to obtain lower reported NNEGS. *Honi soit qui mal y pense.*

Finally, some advice on what the IFoA might do:

*If we make mistakes we want to put things right.* By monitoring any concerns raised, including any formal complaints, and by taking prompt corrective action where necessary, we seek to learn from where things have gone wrong and improve the standard of our service for future users.<sup>7</sup>

That last quote comes from the IFoA's document "Putting things right."

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<sup>7</sup> <https://www.actuaries.org.uk/documents/putting-things-right>.