

BAS Conceptual Framework

Comments by Jeremy Goford on the FRC paper, Preliminary Consultation Paper – Towards a Conceptual Framework

General

1. The style and language of the paper suggests that it has been approached from accountancy-based concepts and adapted for actuarial work. The result is a paper that raises fears that the work of the actuary will be constrained as if it were reporting on history rather than giving informed insights into implications for the future. It is important that actuarially-calculated liability figures for historic accounts are recognised as estimates derived from future cash-flows and not from historic transactions; this feature of actuarial information is insufficiently mentioned.

Actuarial calculations and information are used to support actuarial advice (as in 1.4.1); decision-makers may choose a point-estimate from that advice. Nowadays, that choice is a decision for the client, not for the actuary. Standards for actuaries and/or the output of their work, actuarial information, should be framed as supporting actuarial advice, including the calculation of estimates, with ranges and sensitivities, for decision-makers to make decisions on. The step of incorporating actuarial information within advice is insufficiently mentioned.

As for language, for example, the word 'measure' is used consistently throughout the paper. This encourages a spurious belief in the accuracy of actuarial calculations. Accountants measure; actuaries estimate. It would be helpful if actuarial standards used language that reflects what actuaries do rather than shoehorn them into an inappropriate accounting terminology. The framework should demonstrate that difference in its language. 1.4.8, for example, works well with 'estimation' replacing 'measurement'.

Thus 1.6.1, quite rightly, in my view, advocates standards that apply to actuarial information rather than to actuaries. It can justify that as a sensible thing to do. It is not a virtue that that is what the ASB does;

indeed, it may give a wrong impression that actuarial information is more like accounting information than is the case.

2. Similarly, actuarial advice is generally broad, with an expanding funnel of doubt. That breadth should not be constrained until necessary, eg to satisfy a need to report a point-estimate. Standards should encourage the approach that actuarial work should demonstrate its inherent breadth and discourage limiting actuarial work to producing a point-estimate directly.
3. I see no encouragement for innovation and development in the tools and methodologies to give clients greater insights into the available answers to their questions. It would help to have an acknowledgement that standards should not (just) codify the past but allow modern developments to be reflected in actuarial information and advice ahead of standards being updated. This is more important for actuarial advice than historic reporting. As an example, I would mention the trend to value cash-flows individually using discount rates that reflect the risk in each cash-flow rather than use an aggregate rate to discount aggregate cash-flows (acknowledging 1.7.11 with its caveats). Another would be the fast-changing methodologies in general insurance reserving and rate-making. Standards should include an acceptance that methodologies to provide actuarial information develop continuously and incrementally and standards should not inhibit actuaries from using up-to-date methodologies.
4. I am on the Accreditation Committee of the International Actuarial Association. We are currently redrafting the requirements of an actuarial association (eg the Institute or Faculty) to have a Code of Conduct and what it should contain. Not surprisingly, I am coming across the differing international cultures. There are two features that are of interest.

The first is the trend, in the UK and Europe, towards principle-based regulation. I would like to see BAS standards embrace that trend as far as possible. The second is the desire, mainly amongst UK and Commonwealth countries to base codes of conduct on the needs of

clients (and, maybe, their customers) rather than on the features of products. I am pleased to see that this feature is well-entrenched in the framework.

1.1.4

Whilst it is recognised that the framework is about setting standards, the phrase ‘standardising actuarial information’ smacks of a rigid approach that would not be in the interests of clients.

1.3.3

Maybe sometime in the future, individual decision-makers may have the capacity to make fully-informed decisions. In the meantime, standards should reflect the extent to which actuarial information (and pro-active advice on options and implications) may be framed to encourage a client in the direction that the actuary would go if the actuary were in the client’s position if a client does not have that capacity. The real imbalance of knowledge should not be ignored by BAS; there should be no presumption that even corporate clients are fully capable of absorbing and assimilating the nuances of actuarial information and advice, however well communicated. BAS must decide how far standards should allow an actuary to assist clients in such situations; BAS should not bury it. By acknowledging it, BAS will also help to rein in actuarial arrogance.

1.4

Somewhere in this section it would be worth emphasising the typical chain of process:

- ❖ The actuary uses data, assumptions and methodology to generate actuarial information, which, together with experience, judgement and communication, form actuarial advice to support the decision-making process of the decision-maker.

Decision-makers don’t go straight from actuarial information to decisions; they also assimilate advice, experience and judgement, actuarial and not, from the actuary as adviser. This is not fluffy thinking; it is critical to the

full provision of advice to a client and must not be inhibited by narrowly drafted standards.

This is not the same as usurping decision-makers (1.4.9).

1.4.5

This paragraph refers to methodologies and assumptions. There is no mention of data. There is inadequate recognition in the framework of the importance of the actuary understanding the quality of the data, maybe cleaning it up, maybe making judgements to fill gaps where data is inadequate or messy.

1.4.14

It is good that BAS recognises that risk can be rationally sought as well as avoided and that acceptance can be a positive decision; it would help for BAS to play that up more to help counter the presumption that risk is only to be avoided.

1.4.17

This paragraph could also usefully refer to the responsibility for the quality of data. Indeed, wherever methodology and assumptions are mentioned in the framework, data quality can be mentioned in the same breath.

1.5

A critical element is missing from this section – the use of market data to derive assumptions and to calibrate results. Both are an integral part of actuarial information. Actuaries don't just produce raw results from the application of their methodologies to data, with assumptions. They also test their results for reasonableness against their experience and against the market.

This crucial feature of actuarial work also narrows the 'estimation' and puts some bounds on the range of results. Experience will also help to turn actuarial raw results into informed estimates for incorporating into advice.

1.5.8

Despite the gallant start to recognise that risk can be positive as well as negative in 1.4.14 and a hint of it in 2.4.3, the old attitude to risk as all bad is betrayed in the first blob of 1.5.8. Maybe, ‘something can happen’?

The words ‘incidence’ (incorporating timing and probability) and ‘severity’ (the amount of the benefit/loss) are familiar globally in communicating the nature and consequences of risk. I am not sure how and where they should be incorporated into the framework – and incorporated they should be – but 1.5.8 seems to be trying to invent a completely new way of communicating about the measurement/estimation of risk and its consequences. I think BAS should tread very carefully before trying to introduce a new vocabulary to the communication of risk when there are some good words well understood and in use already. The scope for confusion is evident. BAS may have had a blank piece of paper to work from and may think it is creating a brave new world of output-oriented actuarial standards but it would help if it could relate to the real world and its language where it exists and the real world has perfectly good, understandable and not-misleading words to make its communications.

The separation of variability and uncertainty is valuable and well made.

1.5.11

It would really help acceptance by the audience if the use of ‘flawed’ could be avoided. The first 11 words can be removed without affecting the meaning of the sentence. We don’t need tabloid tricks in a framework from BAS.

1.7.4

The use of ‘complete’ troubles me. I don’t see how you can tell if it is or it isn’t.

Also, in that paragraph there is a presumption that financial information relates to a financial product. Often it doesn’t; the paragraph is too narrowing. It would be a sad day if the effect of a BAS standard were to prevent or inhibit actuarial advice if it doesn’t have a financial product attached to it.

You may care to look at the presentation 'A Professional Job' that suggests that an actuary should leave the decision-maker with the problem, help break the problem down into questions whose answers will assist the decision-maker to reach a solution to the problem. This presentation is referred to in the UK actuarial syllabus and is included, with a voice-over, in the Australian syllabus.

So, the framework might say that actuarial information should answer the questions that were asked in the scope of the work.

1.7.7

I have referred above to the dangers of standardising the past. This paragraph reeks of the constraint of a standard report. I can understand the attraction of a standard-setting body seeking to construct a standard report. I hope, once you have gone through the exercise, you will discover the principles to be followed in writing a report, promulgate those and confine the standard report to the bin.

1.7.10

If a single best estimate is the most appropriate estimation, it would be helpful to have some wording that emphasises that a point-estimate is just that (and, incidentally, not a measurement, as in what can be measured with a tape measure – see 2.4.2). The wording used in Tillinghast engagement letters and reports would be a good starting point. They have been well chewed over in the professional/commercial context of actuarial work; I am sure Tillinghast and other firms would be happy to provide BAS with anonymised versions of engagement letters and standard report wordings.

1.7.12

There is another side to the coin. The methodology used to derive values from aggregate cash flows can, mistakenly, also be used to derive sensitivities to changes in assumptions when the assumption will have a different risk profile to the aggregate. Testing the sensitivity to a particular change in assumptions requires the risk to be tested to have its own profile included in the calculation.

2.3.2

Here is another example of how the concept that actuarial information must relate to a financial product is embedded erroneously in the framework. It doesn't necessarily and the framework must be written to incorporate actuarial information and advice that is not product related. Indeed, this paragraph reads fine with 'product' replaced with 'risk'.