



The Actuarial Profession

making financial sense of the future

consultation response

**Board for Actuarial Standards –
Consultation Paper on Modelling**

Comments from the Actuarial Profession

March 2009



The Actuarial Profession

making financial sense of the future

Ms Louise Pryor
Director
Board for Actuarial Standards (BAS)
5th Floor, Aldwych House
71-91 Aldwych
LONDON WC2B4HN

6 March 2009

Dear Louise

Response to the Consultation Paper regarding Modelling

The Actuarial Profession welcomes this consultation paper upon which we offer some high level observations and comments for the Board's consideration.

The paper is a well written and researched document which sets out a very detailed set of principles for controlling models. It is hard to be critical of the intent or the detail contained within the paper, which sets out a high threshold for best practice. We are in full agreement with the BAS Chairman's comment that users of actuarial information should not only understand how useful the underlying models are, but also understand their limitations. That said, we do have some more fundamental issues concerning the setting of standards in this area.

As the paper and the accompanying documents make clear, models are not solely for use by, nor the sole responsibility of, actuaries. Even where a model provides information for work reserved to an actuary, the primary modelling work can be performed by non actuaries. Our primary concern therefore is to achieve clarity about the application of this standard: to whom and to what does it apply, and how? We think it would be helpful if the document itself were to cover this more explicitly rather than assuming that readers had prior knowledge of the BAS Conceptual Framework or Scope and Authority documents. Otherwise there is a danger that users of models and users of actuarial services could be confused about the application of the standard.

As we understand it, BAS generic standards will only apply to actuaries (members of the Faculty or the Institute of Actuaries) when undertaking the work covered by specific BAS Technical Actuarial Standards. While we generally support the standard as a statement of best practice we

Faculty of Actuaries
Maclaurin House
18 Dublin Street
Edinburgh EH1 3PP
Tel: +44 (0)131 240 1300
Fax: +44 (0)131 240 1313
e-mail: faculty@actuaries.org.uk
www.actuaries.org.uk

Institute of Actuaries
Staple Inn Hall
High Holborn
London WC1V 7QJ
Tel: +44 (0)20 7632 2100
Fax: +44 (0)20 7632 2111
e-mail: institute@actuaries.org.uk
www.actuaries.org.uk

Institute of Actuaries
Napier House
4 Worcester Street
Oxford OX1 2AW
Tel: +44 (0)1865 268200
Fax: +44 (0)1865 268211
e-mail: institute@actuaries.org.uk
www.actuaries.org.uk

agree with BAS that it would not be appropriate to require it to be followed in relation to all work undertaken by members of the Profession. Such an approach could lead to an unintended consequence: because the standard sets such a high threshold, the potential compliance cost might lead organisations to avoid the use of actuaries for general modelling work. This would not necessarily be in the public interest. (For clarity, we argue here from the perspective of the general good of having professionals involved who are subject to high ethical obligations and discipline. We are not looking to argue that all modelling activity should be undertaken only by actuaries.)

In the absence of any current BAS Technical Actuarial Standards we have found it difficult to consider what the practical implications of using the modelling standard might be, or what enforcement issues we might face as the Professional body for the only people required to follow the standard. We also question how BAS might have been able to undertake any realistic regulatory impact assessment in such circumstances. The standard therefore may need to be revisited and revised once a suite of Technical Actuarial Standards are in place.

The value of a standard for modelling has been put into focus during the recent financial turmoil, particularly where the risk models used by banks have been questioned. We think it would be valuable to extend the reach of this quality standard to other professionals beyond actuaries. We would encourage the FRC, as a public interest regulatory body, to press other regulators to require the entities they regulate to follow such a standard in prescribed circumstances. BAS should also discuss with its sister operating boards within the FRC, which set standards in accountancy, how it could be incorporated into their regimes.

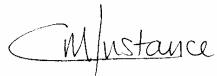
We note also that there are other bodies who may introduce specific requirements in relation to models. One example is the FSA who may do this as part of the proposed Solvency II regime. It will be essential that BAS work with the FSA to ensure that the two sets of requirements are complementary.

The paper is ambiguous on the definition of a model. Models can range from a very simple one page spreadsheet (or less) delivering results instantaneously to a large-scale stochastic model with multiple reporting, which takes a day or more to run. The model controls should be commensurate with the model's size, but the communication and explanation of the results should be broadly of a common and consistent standard.

Finally, even as best practice, the high threshold this standard sets for modelling could be perceived as being too idealistic for all circumstances. A well explained simple model, with results produced from a variety of assumption sets can add much value. The existence of a modelling standard should not put the production of such effective models at risk.

We hope that this feedback is of use to the Board in developing its thinking on modelling. We would be happy to meet to discuss this response and the responses of others, either at one of our regular meetings or on a specific occasion.

Yours sincerely

A handwritten signature in black ink, appearing to read 'C Instance', written over a light grey rectangular background.

Caroline Instance
Chief Executive