

21st Century Risks & Rewards for Actuaries
IACA, PBSS and IAAust Colloquium
31 October – 5 November 2004
Shangri-La Hotel, Sydney, Australia

SYNOPSIS

Financial Economics and Actuarial Practice

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Starting in the U.K. and continuing through the U.S. and Canadian actuarial professions, proponents of financial economics have been forcefully promoting a review of traditional actuarial practices and training. In particular, the financial theories first proposed by Modigliani and Miller and subsequently developed by others have been used to highlight serious weaknesses in typical actuarial thinking. In summary, it is claimed that much actuarial advice wrongly specifies value, that guidelines and standards need radical revision and that traditional actuarial intuition suffers in comparison to newer modes of thought adopted by other professions.

This paper examines concepts from both financial economics and actuarial science as applied to defined benefit schemes using a simple discounted cash-flow framework as a reference point. The general finding is that many standard modes of actuarial thought are, in fact, indefensible when examined with the tools and techniques of financial economics. The call for revision of actuarial training and practices is credible and necessary.

However, the paper also touches on areas where a heavy-handed application of finance theory could be misguided due to limitations in the simple financial economic models presented. It concludes that financial economics should be carefully integrated into actuarial thought, rather than appended to existing actuarial theory or inserted as a wholesale replacement.