

IAA Joint Section Colloquium

Online

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Are actuaries independent
guardians of financial security
or just telling a convenient tale?

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About the speaker

- Dr. (rer. nat.) Michael Fackler, Munich, Germany
- Qualified actuary DAV, self-employed
- University at Munich & Pisa:
math, physics, & some philosophy
- Doctorate at Univ. Oldenburg, in parallel with
working: on experience rating, completed 2017
- 10 years with leading reinsurers
- 15+ years as consulting actuary
- Main areas: non-life reinsurance pricing, scarce data

London Market debate: Excerpts

*Is there evidence for **market-wide group think**?*

Tredger et al.

*Financial markets are also **social** structures.*

Weick et al.

*The review noted that frequent industry use of the phrase “**this is common in the industry**” ... was striking.*

Haddrill et al.

more

*It is inevitable that some modelling practices are **social constructs**.*

*Management **may not want to be told** how uncertain the estimates are.*

*“People **believe** in this model. If we [the actuaries] say it is wrong, it **undermines us and the model**.”*

Frankland et al. [paper & discussion]

Collective self-deception?

- Does insurance modelling reflect reality quite well, or rather draw a socially agreed picture?
– *real vs perceived security* –
- Do actuaries (have to) go with the crowd?
– *independence* –

Observation:

- In case of high **uncertainty**, everyone prefers to work with an **optimistic** actuary.

Background 1 Psychology: Confirmation bias

It is harder to crack prejudice than an atom.

Albert Einstein

Background 2 Anthropology: Peer pressure

In order to be an immaculate member of a flock of sheep, one must, above all, be a sheep.

Albert Einstein

Background 3 Sociology

Trust is the foundation of society.

Frederick Douglass, abolitionist & statesman

Social trust

- In **large** social groups we have to deal with a lot of strangers.
- Here cooperation requires a **leap of faith**: the belief that the community (system) in principle works.
- Social trust relies on **shared** convictions and narratives.

Fighting for trust

Dilemma: Social trust builds up very slowly, but can erode in a second.

Essential: The community must be **perceived** as functioning properly.

Possible actions:

- arduous: **real** improvements of the system
- clever: myths, propaganda, **window dressing**

Both variants occur.

Both variants work.

Example

*Ein solch Papier, an Gold und Perlen statt,
ist so bequem, man weiß doch, was man hat.*

*Such paper's convenient, for rather than a lot
Of gold and silver, you know what you've got.*

Mephistopheles, demon
(in: Johann W. von Goethe, *Faust, Part II*)

Money

- **Fiat money** (banknotes, scriptural money) is basically a promise: that the current economic system will function in future.
- The belief in this promise is the basis of the modern economy

Bottom line: A **subjective** feeling is the **real** basis of the economy.

- The system works – at least for some decades in a row.

Insurance

... hinges crucially on social trust – within and beyond the industry:

- money-based
- complex
- long-term
- volatile
- subject to uncertainty

Fighting for reputation

- Social distrust may affect single insurers – or the industry as a whole.
- No one wants such distrust to arise – and it is this pressure that the actuaries ultimately feel.

The Transparency Dilemma of risky environments

The actuary's role: ensure transparency as regards risks and uncertainty.

But:

- The more **transparency** you achieve, the more **problems** may come to light.
- This enhances **real** security, but can undermine **perceived** security, as too much bad news erodes social trust.

Two tough questions

1) **What** is the optimum amount of transparency?

Rough estimate: $0 \ll x < 100\%$

2) **Who** decides what is rendered transparent and what isn't?

- Sometimes actuaries are the ones who decide, presumably not badly, some even like to do that.
- However, such decisions **manage social trust**, which is not an independent **expert role**, but a **political** one.

Conclusion

Generalising beyond insurance:

- Managing complex risks in large communities involves striking a balance between **self-critical transparency** and **cultivating an image that builds trust**.
- **Independent experts** can have a key role in this, but it is one that is **at risk** of merging with a political role.

The End

Thanks for joining this talk.

See the paper for details (colloquium website or SSRN).

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