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Public interest, purpose-driven institutions and the actuary as arbiter of the ethical process.

By Nico Aspinall

This note is based on opening remarks made by Nico Aspinall in the Institute and Faculty of Actuaries' Finance in the Public Interest webinars hosted in mid-March 2021.

Nico Aspinall is the Chief Investment Officer for B&CE which includes The People's Pension, the largest DC Master Trust in the UK. He is the former Chair of the Resource and Environment Board of the IFoA and previously Chaired the Research sub-committee of the Board. His previous roles include Head of Defined Contribution Investment for Willis Towers Watson; Head of DC and Communications for the Barclays UK Retirement Fund; and as an actuarial pensions consultant for Deloitte Total Rewards and Benefits.

Nico received a Master's in Theoretical Physics from the University of Cambridge in 2004.

The Actuaries for Transformational Change is a group of leading actuaries who came together to stimulate thinking on how actuarial practice can be transformed to help to achieve the social impact goals of our time.

I was delighted to be given the opportunity to contribute to a panel session as a part of the Presidential series on finance and the public interest the other day. I covered a number of points in my introductory remarks I hope you'll find worth me setting out more formally in this paper. In a nutshell I'll argue that:

- The concept of the public interest aligns well with public goods, commons and externalities to business.
- That purpose-driven organisations treat these as external capitals they rely on rather than externalities they can ignore.
- That actuaries should see themselves as the arbiter of the processes an organisation takes to translate its stakeholders' objectives into strategy.

- That ethics relates to the clarity of the actions an organisation takes and its purpose.

Along the way we will need to recapture a spirit of institutional subjectivity abandoned by a "market knows best" mentality.

Public interest and capital – reimagining externalities

It has always been a struggle for the IFoA to talk about the public interest because it has been suggested that individual actuaries can't act in the public interest as they have to act within a corporate or advise a single client. This has meant the role of acting in the public interest has fallen to the IFoA. In this capacity the IFoA has sought to ensure the markets actuaries operate in have the public interest at heart, but does nothing to ask any of the individual firms or actuaries to act in this way.

This is a narrow and legalistic framing of the public interest which makes it meaningless. It is time for us to reappraise this term and note that not only do individual institutions act for and against the public interest, but also that individual actuaries certainly need to be conscious of it and ideally act in the public interest.

Institutions rely on capitals that sit within and without of the control of the board. The "ESG" framing (Environmental, Social, Governance) gives examples of these capitals including environmental capitals, like having trees and plants to deliver oxygen to us and to absorb our waste carbon dioxide; social capitals like ensuring that there is a healthy and sufficiently educated pool of staff who can be employed; governance capitals like having good mechanisms to identify and resolve the concerns of stakeholders. Of course we could define a huge number of different capitals. It is important to note, that the capitals an institution defines are likely to be subjective and reflect what it relies on from outside of itself.

All these capitals are networks relying on multiple agents exchanging services between themselves and between networks; and they are all vulnerable to collapse if you push those networks too far out of kilter. Institutions can take actions to erode or enhance these capitals. To the extent that they erode capital they rely on, and particularly if they push the networks beyond the point of collapse, they are unsustainable.

As we commonly construe and govern the corporation, none of these capitals are very important. The corporation is focussed on financial capital, which is of course not capital at all. Finance is a tool to appropriate capitals for the use of the corporation, and can be measured as the exchange value of capitals. Finance itself cannot be a capital in itself as it does nothing. We should of course note that the construct of money, credit and finance ie that society accepts we can use it in exchange for capital is part of the social capital a company relies on. This is just as vulnerable to collapse as other capitals, just look to the examples of hyper-inflation or to witness the collapse of money as social capital.

So we have a funny system where many corporations are focussed on money, the one thing which isn't capital, and unfocussed on the capitals which are most important to their survival. Actions which erode external capitals, which economists might refer to as externalities, are just as unsustainable as actions which erode internal capitals. The result of this is corporations focussed measuring and creating metrics of short-term profit as opposed to the sustainability of the capital they need to exist.

The purpose-driven, subjective institution

The purpose of a company is not to make a profit, whatever Milton Friedman thought, the purpose of a company is to add value to its capital network. If a company adds value well, meaning it builds its own and it's network's capitals, then the profit will flow. No baker should prioritise profit, they should prioritise baking bread. Of course they have to worry about whether it will sell, how much to charge and the costs of baking bread, but if they see their purpose as profit and not feeding people bread they will fail as a bakery business.

The purpose of the corporation or institution is an understanding of how it adds value to its capital network and to take actions to maximise that value add. This requires a difficult, and very open conversation with all stakeholders around that purpose, and it must be recognised this will result in compromise and choice. This can be framed as the strategy conversation, or defining the value chain. Much of what the company does is

encapsulated in the statement that it uses external capitals from suppliers to combine into products which enhance the capitals of its consumers. It is able to take profit out of this equation because the value add to its customers is greater than the value taken from its suppliers. There is nothing new here, except the recognition that the wider environment and society are suppliers of capital.

Knowledge of the capitals institutions interact with and rely on and serve; measures of whether their interactions have led to an improvement of those capitals or not; and the ability to observe whether critical thresholds are being approached beyond which capital provision might collapse are all that is required to create a more sustainable corporation. A supermarket might feel it is doing a good job to push the prices of milk downwards as it can supply more milk to its consumers, but if the downward pressure on farm prices threatens the dairy industry in the long-run this is a self-defeating action.

Different capitals are of course important to different types of business. There can be no "one size fits all" template given to institutions as to what they should worry about, each busines is different. This makes the decision around purpose and the valuation of capital prices subjective.

This is a really important rebuttal of financial economics. Every institution has a subjective valuation of the capitals they rely on; accommodating different risks because it has different capitals at risk and subjectivity around its risk budgeting. Yes, markets come together with subjective preferences to give an observable price. But, no, this does not make this the correct valuation for any institution exchanging. Observable prices are not objective prices. An institution which can choose between substitutable capitals will choose to purchase the one which offers the greatest value added in it's value chain given the outlay of finance, not purchase them all because they are all the "right" price.

The role of an actuary

Actuaries are the individuals who can bring together and resolve the problems that come with having multiple stakeholders with different perspectives. No longer should they be focussed on financial metrics and thinking only about shareholders or only risk holders. Instead the actuary should be broadening that out to all of the providers of capital.

This would incorporate the views of the consumer, the staff and other suppliers, the environment and wider society as well as the owners and managers of the business. A business which does not seek to incorporate the full plurality of the capitals it relies on in the conversation about its purpose and strategy is doomed to fail in the long-run.

Actuaries use maths to go among those stakeholders to find a common language, or common model to reflect their view of the corporation and the collective who has interests in it. As a part of this, though, we must also recognise that there is no one set of maths that can capture all views of all stakeholders. These are "wicked problems" meaning that each stakeholder brings a different understanding of what the purpose is behind the corporation, what it is there to provide. In approaching wicked problems we need plural maths. One model is the worst possible outcome because it most likely ignores features important to stakeholders, or perhaps shows that the institution does not care about their perspectives. Two models which give different perspectives on a problem can indeed give a better understanding even if that feels complex to the client. The role of the actuary is to take the client through the complexity of compromising deliberately between the outputs of multiple modelling results, rather than relying on one and failing to realise it is already a compromise. The compromise of the selection of a single model is implicit, the compromise in determining the result hovering between two model outputs is an explicit compromises. Only explicit compromises can be monitored for the moment when they are no longer desirable.

This incorporates the critical understanding that there is no perfect or optimal solution. The world is full of compromise and satisficed (not optimised) solutions. My view is that actuaries are capable of living in a role as the arbiter of those compromises, acting to help institutions find better mediations between all stakeholders rather than pretending there is a "right" answer.

Actuaries must also recognise that there are some topics which are simply unmodellable. There are topics beyond maths. Here the actuary can use their skillset to talk to scenarios. They may have mathematical results, but may not have followed a mathematical route to get there.

The ethics of process

This then leads into the topic of ethics, which of course all professions have to grapple with. My view is that the actuary ensures an ethical outcome through a good process. A part of this is recognition that the process will be subjective and aligned to the institution's purpose. A well-designed and well-followed process which talks to a common understanding of purpose and which results in a strategy which speaks to achieving that purpose is an ethical process and an ethical strategy. This makes ethics subjective.

A company which takes actions which are against its purpose is therefore acting unethically. An example here might be the uses of derivatives and short-term trading. An investment company may have a clear purpose to make long-term investments on behalf of its clients. It is clearly unethical for them to be gambling with policyholder money by shorting companies or using derivatives with no underlying risk exposures in their portfolios. A policyholder who has not been taken through an understanding of the objectives of the product they are buying cannot determine whether it matches their objectives or ethics. The shorthand of profit instead of the rich complexity of an articulated and comprised purpose enables all sorts of behaviour which can be unsustainable.

We need to re-imagine the role of the actuary and incorporate their role of acting in the public interest.

Conclusions

Perhaps you will not recognise the actuary as I have described them here. Perhaps you will feel that there are barriers to you or your clients acting in this way. The first challenge must be to you, as holder of those views. What kind of culture do you wish to operate within? To lead a client to act against their own long-term interest because the prevailing answer tells you this is right is to act against the public interest, and is no better than an agent of evil shrugging their shoulders and saying they are just following orders. We must be the change we wish to see in the world. In the end unethical acts (as I have defined them) will catch up with you. An unethical action is one against the purpose of the client, so make that purpose more explicit where it is unclear. We need actuaries to be brave in standing against the status quo where this is harmful to our clients, and in defining the stakeholders in this decision as holistically as possible. Anyone or anything effected by the decisions you support should be in the loop.

You may also argue that the techniques you were taught do not provide you with the tools to act in this way. Then design new tools. The most enjoyable aspect of actuarial practice as I have experienced it is in the blank piece of paper slowly filling in with a possible route to a solution. Recapture that joy. Our profession must invest in the tools to recapture the subjectivity of institutions; either in the centre of the IFoA or in its many villages, the individual actuaries and their employers. But do not fall back on "I have not learned this": go and teach yourself. I note the word "recapture" because we had some of these tools before and have abandoned them. Financial Economics is the antithesis of the prevailing orthodoxy of the previous generation, the thesis that each institution could have a distinct valuation of assets reflecting their use of them, the Discounted CashFlow (DCF) model. We must find a synthesis between the DCF and Financial Economics. I believe this is cultural in accepting two answers are better than one, rather than in new maths, but perhaps you will discover a way to mathematise a nuanced approach. Many other disciplines need their thesis and antithesis to be synthesised. What an exciting time to be in actuarial practice! Go and put your name on an approach which will be taught to the generations that follow us.

You could argue that it is not in your nature to be able to communicate the true complexity of the real world or live outside of maths. Push yourself outside of your comfort zone. I doubt that anyone interested in building models of the world cannot make their enthusiasm contagious. But learning how to infect others with your

knowledge must be a conscious process where you learn from failure. So go and fail. In the long-term you will develop and hear more from your clients about what works than you think is possible.

Perhaps you blame the regulators for constraining you from acting in your clients' interests? Then add your name and your company's name to the list of those providing thoughtful responses to consultations and calls for evidence and highlight this issue. We are the regulatory system. It is silence that weakens regulation, not government. We must speak out and say clearly that the prevailing "market knows best" approach is not only wrong, but de-humanising. There is no course of treatments that will work in all circumstances without knowledge of the patient, so let us make sure that the government and regulators can hear that an approach which creates rules both enables loopholes and increases the fragility of the system in a way that is not anticipated in the rule-making.

I do not make these statements with knowledge of how actuarial practice will evolve; only with the observation that it must evolve to enable it to be relevant in the coming years. If you see that challenge as too much for you, then at some stage you will no longer be an actuary, you will be unable to complete your CPD. I can tell you that not only it is not beyond you, it is a core strength you have been neglecting. I know this because I took the same exams as you and faced the same challenge. Bring out this strength again, re-learn the joy of not knowing the answer, and participate in the reinvention of the profession for the public interest.

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Ashok Gupta
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