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Pension Case Study (Professional) - Balancing Ethics and Estimates

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Agenda

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2. Case Study Overview
3. Professional Issues in the Case Study
4. Handling the Issues and Proposed Resolutions
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1. Professional Environment for a Pension Actuary



Professional Environment for a Pension Actuary



The **Actuaries Act, 2006** is a legislation that governs the profession of actuaries in India. Its key objectives are:

- To regulate the profession of actuaries through the establishment of the *Institute of Actuaries of India (IAI)*
- To set standards of professional conduct, education, and qualifications for actuaries
- To protect public interest by ensuring that actuarial work is carried out with integrity, competence, and accountability
- To provide disciplinary mechanisms for professional misconduct by members of the IAI

Professional Environment for a Pension Actuary



The **Professional Conduct Standards (PCS) Version 4.0**, issued by the Institute of Actuaries of India (IAI), sets out principles and expectations for actuaries to ensure integrity, professionalism, and quality in their work. The objectives of **PCS 4.0** are:

- To uphold the reputation of the actuarial profession
- To provide a framework for professional judgment
- To guide actuaries/members in maintaining public confidence
- To support actuaries in handling conflicts of interest, confidentiality, and communication

Professional Environment for a Pension Actuary



Mandatory Standards issued by the Institute of Actuaries of India (IAI), **Actuarial Practice Standards (APS)** and **Guidance Notes (GNs)** play a critical role in ensuring consistency, professionalism, and credibility in actuarial work.

For pension and employee benefits valuations, **APS 27** is the current mandatory standard for actuaries performing valuations of employee benefits like gratuity, leave encashment, pensions, long service awards, post-retirement benefits etc.

Apart from these there is APS 15, APS 20 and Guidance Notes (GN) 29 issued by IAI.

Professional Environment for a Pension Actuary



The **Companies Act** and **Accounting Standards** (AS, Ind AS, IAS/IFRS, US GAAP) play a foundational role in shaping actuarial valuations, especially for various employee benefits.

The Companies Act and applicable Accounting Standards together define the methodology, basis for setting assumptions, disclosure requirements, audit trail expectations, and professional standards that actuaries must follow to ensure integrity and transparency in actuarial valuations.

2. Case Study Overview

Case Study: Balancing Ethics and Estimates

Background:

You (say Actuary Mr. C) are a pension actuary practicing in the area of Employee Benefits. A representative of a big company approached Mr. C for actuarial valuation of gratuity benefit of their employees and Mr. C accepted the assignment.

Scenario: A junior employee of Mr. C did all the calculations and reached out to him with significant difference in the current calculated liability and the liability estimated in the previous year's report. The difference was much higher than the normal expected range. There were some differences in the assumptions (most notably in discount rate) and some data reconciliation issues not highlighted in the previous year's report.

Case Study: Balancing Ethics and Estimates

Scenario...

The actuarial valuation of previous year was done by a Senior Actuary (say **Mr. P**) having lot of experience in this area.

When the junior employee of Mr. C tried reaching to Mr. P's office, his staff refused to officially comment on the differences but he informally got to know that Mr. P did some modifications, especially in the discount rate to lower the liability on the request from the CFO of the Company (client).

When Mr. C tried contacting Mr. P over a call, he did not take the call and messaged that he is travelling and not in position to talk for next few weeks.

Case Study: Balancing Ethics and Estimates

Challenges:

- What are the professional issues involved in this case study?
- How to handle and resolve this issue?

3. Professional Issues in the Case Study

Professional Issues in the Case Study

Acceptance of the assignment and communication with the previous actuary:

As per Section 7 of Professional Code of Conduct (PCS) V4.0 and Item 5 in Schedule Part I of Actuaries Act, 2006, If an actuary invited to provide actuarial services to a client, knows or has reason/s to suspect that another actuary is acting or has recently provided advice on the same or a related matter, the actuary should communicate, in writing, with the other actuary at as early a stage as possible to ask whether, he is aware of any professional reasons to be considered in accepting the appointment or any particular considerations which ought to be borne in mind before providing actuarial services.

If, however, the client, having been informed of the obligation to make contact, refuses to consent to contact being made, the appointment should be declined

Professional Issues in the Case Study

Acceptance of the assignment and communication with the previous actuary:

It is not mentioned if the current actuary Mr. C have taken consent or written for the consent from the previous actuary Mr. P before accepting the assignment. It is also mentioned the Mr. C tried reaching Mr. P via calls and a junior staff also tried reaching previous actuary's office.

As required by Section 7 of Professional Code of Conduct (PCS) V4.0 and Item 5 in Schedule Part I of Actuaries Act, 2006, Mr. C should write at as early a stage as possible to check with Mr. P for any professional reasons to be considered in accepting the assignment. Also, it is essential and specifically written in the standard that the communication should be via a written mode so preferably an email.

Professional Issues in the Case Study

Internal review of the work:

The junior employee of Mr. C did all the calculations. It is not specified if the calculations were checked/reviewed by a senior employee or by Mr. C himself.

The work of a junior employee should be checked and reviewed thoroughly by a senior employee and/or by Mr. C himself before making any conclusion or communicating results to anyone.

*It is important to maintain the confidence in work of actuaries and in the actuarial profession as required by **Section 2.1 and 2.3 of the PCS V4.0.***

Professional Issues in the Case Study

Agreeing to CFO's request:

From the informal information it is known that the CFO of the client requested for a lower liability number and Mr. P obliged the same by making some modifications, especially the discount rate.

*As per **Section 1.4 of PCS V4.0**, A member must, avoid arrangements which inhibit the member's ability to conform to the standards of behavior, integrity, competence and professional judgment.*

*Also, as highlighted in **Section 6.1 of PCS V4.0**, Actuaries must ensure that their professional judgement is not compromised, and is not seen to be compromised, by any bias, conflict of interest or the undue influence of others.*

Professional Issues in the Case Study

Reacting to an Informal Information:

From the informal information it is known that the CFO of the client requested for a lower liability number and Mr. P obliged the same by making some modifications, especially the discount rate.

Actuaries in practice should not form any judgement about the previous actuary's work only based on the informal information, however may use this information further for internal investigations on the differences in liabilities.

*Actuaries must consider **Section 2 (professional standards)** of the **PCS V4.0** while dealing with the informal information about the previous actuary's work or in case of any difference in opinions.*

Professional Issues in the Case Study



Issues in the previous year report:

There seemed to be some data reconciliation issues but those were not adequately highlighted in the previous report.

As specified in Section 1.2 of the PCS V4.0, an actuary must comply with the requirements of the Act and Rules &, professional guidance and other guidance and standards such as APS, GN and Accounting Standards in preparing the reports. This is applicable for both Mr. P as well as Mr C.

Professional Issues in the Case Study

Issues in the previous year report ...

An actuary in practice shall be guilty of professional misconduct as per items 13-17, Schedule Part I of the Actuaries Act as below:

Item 13 - If he fails to disclose a material fact known to him in a valuation report or a financial statement, but disclosures of which is necessary to make the valuation report or the financial statement not misleading where he is concerned with such valuation report or the financial statement in a professional capacity.

Item 14 - Fails to report a material misstatement known to him to appear in a valuation report or financial statement with which he is concerned in a professional capacity.

Professional Issues in the Case Study

Issues in the previous year report ...

Item 16 - If he fails to obtain sufficient information to warrant the formation of an opinion in regard to any matter contained in any valuation report or financial statement prepared by him or on his behalf.

Item 17 - If he fails to invite attention to any material departure from the generally accepted procedure or professional work applicable to the circumstances, in any valuation report or financial statement prepared by him or on his behalf.

Professional Issues in the Case Study

Communication and Responses:

Mr. C tried contacting Mr. P to which he responded that “he was travelling and not in position to talk for next few weeks”. Also, his staff refused to officially comment on the difference.

Delays in response may occur due to genuine reasons. However, actuaries must aim to respond promptly to uphold client confidence in their competence, objectivity, and integrity, thereby reinforcing trust in the profession.

The initial communication took place between junior employees, which is inappropriate. Such discussions should begin between the signing actuaries. Subsequent interactions can involve other team members, but the signing actuaries must remain informed.

4. Handling the Issues and Proposed Resolutions

Handling the Issues and Proposed Resolutions



Understanding importance of the liability movement:

- The movement in the liability affects the financials of the Company
- It is important that the liability movement is reasonable vis-à-vis the movement in the data and assumptions
- Companies generally make month-on-month provisions for their budgeting and cash-flows planning
- Hence, any large deviations from the budgeted provisions may distort the Company's financial planning

Handling the Issues and Proposed Resolutions



Internal Review:

- It is a natural professional duty of an Actuary to ensure that any valuations/calculations carried out him/her and/or their office are correct to the best of their knowledge and suitable for the purpose of the valuation
- The calculations in this case were performed by a junior employee. It is important in general that all the calculations are reviewed for their correctness and suitability for the purpose.
- As the movement in the liability is coming out to be much higher than normally expected in this case it becomes even more important that the calculations are double checked for its accuracy and completeness

Handling the Issues and Proposed Resolutions



Internal Review (continued)

- It is important to breakdown the movement of the liability to understand the various factors contributing to the movement
- The process of breaking down the liability movement may also help identify errors/inconsistencies (if any) in the model used for the liability estimation
- It will also help in identifying outliers (if any) contributing to the liability movement
- It will also help quantify 'more than expected' difference in the liability movement

Handling the Issues and Proposed Resolutions

Factors that impacts liability movement:

- It is mentioned that there are some inconsistencies in the data and some discount rate issues. Hence it is important to analyze the impact of the data inconsistencies and assumptions separately.
- Other factors that contribute to the liability movement are:
 - Change in Assumptions
 - Change in Scheme Rules
 - Discretionary benefits (if any)
 - Difference in modeling approach
 - Change in purpose of valuation
 - Change in statutory laws

Handling the Issues and Proposed Resolutions



Communicating results to the Client:

- A comprehensive analysis of the movement in the liability would help in communicating the results to the client in an effective and objective manner
- A detailed presentation of the results and the liability movement to the client will promote the confidence in the work carried out by the current Actuary
- Very important to keep in mind section 2.4 of the PCS while communicating the results to the client and expressing opinions (if any) on the previous year's valuation

Handling the Issues and Proposed Resolutions

Communicating results to the Client (continued)

- The informal information received from the previous Actuary's office cannot be relied upon and should not be mentioned to the client
- It should be borne in mind that two actuaries/members can have different opinion on the same matter and hence communication should be professional and respectful even when expressing differing opinion
- Client may be informed about various other possibilities/scenarios which may have led the previous Actuary to form a differing opinion

Handling the Issues and Proposed Resolutions

Regarding seemingly abnormal discount rate:

- Liability estimation is generally very sensitive to the discount rate considered for the valuation. Below mentioned points needs to be kept in mind when forming opinion on the discount rate considerations:
- Discount rate used for the actuarial valuation is dependent upon:
 - Purpose of the valuation (Accounting, Funding, Regulatory etc)
 - Estimated term of the liability
 - Source from where the yield on the bonds has been taken
- It is to be noted that there is no prescribed source for taking the yield on the bonds in India and hence discount rate could vary even for the same estimated term.

Handling the Issues and Proposed Resolutions



Considerations for current year's valuation

- Current year's report should be fully compliant with the relevant accounting standards, APS, regulations and should be appropriate for the purpose of the valuation
- Comment in detail regarding the data inconsistencies from the previous valuation. Any approximations made should also be listed
- Comment on the reasonableness and appropriateness of each of the assumptions and the source each of them were derived or received from
- Mention the source from where each of the assumptions were derived or received from

Handling the Issues and Proposed Resolutions

Considerations for current year's valuation (continued)

- In case if the current actuary is not reasonably convinced on any of the assumption/s provided by the client then the same should be highlighted in the report with the rationale
- As stated in section 2.1 and section 6.1 of the PCS, the report should be prepared with absolute integrity, ethics and without any influence from the client or any other party
- Generally reports include previous year's numbers for comparison. It should also be mentioned in the report that the previous year's numbers were estimated by a different actuary so that the users of the report are aware of the transition.

Handling the Issues and Proposed Resolutions



Other Professional Considerations:

- In case the 'inexplainable' difference in the liability movement is significant then the current actuary may discuss the matter with the pension, employee benefits and social security advisory group before issuing the final report
- The current actuary/his office should communicate in writing with the previous actuary/his office. This would help in documenting the issues (if any) and also help recording of the responses (if any).
- The current actuary can inform the client about his efforts to reach out to the previous actuary/his office for seeking the clarifications (if any) and the responses received (if any) from them

Handling the Issues and Proposed Resolutions



Other Professional Considerations (continued):

- The current actuary can try to reach the previous actuary after few weeks again to discuss/seek his inputs on the queries (if any)
- In case there is no satisfactory response then this may be a possible professional misconduct
- The current actuary may then discuss the issue with another member. Confidentiality of the client's information should be handled carefully when discussing the issue with other member/s.
- It should be borne in mind that there can be a genuine reason that the previous actuary/his office is not able to respond timely

Handling the Issues and Proposed Resolutions

Other Professional Considerations (continued):

- In case the current actuary is not reasonably satisfied with the discussions and the developments to the issue, then the matter must be referred to the professional body
- The matter must also be referred to the professional body if the current actuary is reasonably satisfied that there is a possible professional misconduct
- The client also can take the same approach of reaching out to the previous actuary for seeking clarifications and may report to the professional body in case it finds it necessary

Thank you!

Q&A

