

Reputation Risk in Transactions

Reference material

Todd J Hess
Seminar on Reinsurance, June 2020

Why relevant for Actuaries?

- Code of Professional Conduct (COPC)
- Actuarial Standards of Practice (ASOPs)

COPC1 Professional Integrity

1. An Actuary shall act honestly, with integrity and competence, and in a manner to fulfil the profession’s responsibility to the public and to uphold the reputation of the actuarial profession.

COPC 1 Professional Integrity.

1-2 An Actuary shall not provide Actuarial Services for any Principal if the Actuary has reason to believe that such service may be used to violate or evade the Law . . .

ASOP 7 Analysis of (L&H, P&C) Cash Flows

3,8 Reinsurance. The actuary should consider whether reins receivables . . impact on the cash flow analysis

COPC 8 Control of Work Product.

An Actuary who performs Actuarial Services shall take reasonable steps to ensure that such services are not used to mislead other parties.

COPC1 Professional Integrity

1-4. An Actuary shall not engage in any professional conduct involving dishonesty, fraud, deceit, or misrepresentation

ASOP 41, Actuarial Communications

3.4.4 Responsibility for assumptions and methods

COPC 3 Standards of Practice

An Actuary shall ensure that Actuarial Services performed by or under the direction of the Actuary satisfy applicable standards of practice.

Complex Structured Financial Transactions (CSFT)

Regulatory rules to be aware of when structuring transactions

When structuring/selling/reviewing CSFT every party should be aware that such transactions might pose heightened levels of legal or reputational risk to the relevant institution due to:

- Lack economic substance or business purpose;
- Are designed or used primarily for questionable accounting, regulatory, or tax objectives, particularly when the transactions are executed at year end or at the end of a reporting period for the customer;
- Raise concerns that the client will report or disclose the transaction in its public filings or financial statements in a manner that is materially misleading or inconsistent with the substance of the transaction or with applicable regulatory or accounting requirements;
- Involve circular transfers of risk (either between the financial institution and the customer or between the customer and other related parties) that lack economic substance or business purpose;
- Involve oral or undocumented agreements that, when taken into account, would have a material impact on the regulatory, tax, or accounting treatment of the related transaction, or the client's disclosure obligations;
- Have material economic terms that are inconsistent with market norms (*e.g.*, deep "in the money" options or historic rate rollovers); or
- Provide the financial institution with compensation that appears substantially disproportionate to the services provided or investment made by the financial institution or to the credit, market, or operational risk assumed by the institution.

OCC BULLETIN 2007-1

<http://www.occ.gov/news-issuances/bulletins/2007/bulletin-2007-1.html>

NY Ins Dept Circular on Finite Reinsurance. March 2005

Chief Executive Officer to attest, under penalty of perjury, that with respect to cessions under any reinsurance contract, that:

- I. there are no separate written or oral agreements that would under any circumstances, reduce, limit, mitigate or otherwise affect any actual or potential loss to the parties under the reinsurance contract; and
- II. for each such reinsurance contract, the reporting entity has an underwriting file documenting the economic intent of the transaction and the risk transfer analysis evidencing the proper accounting treatment, which is available for review.

In addition, the Department will require increased disclosure of finite risk transactions in the annual statement, including the attestation described above."

http://www.dfs.ny.gov/insurance/circltr/2005/cl2005_08.pdf

References

(1 of 4)

The principle source for this talk is from the US Dept of Treasury Office of the Comptroller of the Currency.

<http://www.occ.gov/news-issuances/bulletins/2007/bulletin-2007-1.html>

The guidance following the list of 7 characteristics reads:

“The statement points out that if a financial institution determines through its due diligence that participation in a particular CSFT would create significant legal or reputational risks for the institution, the institution should take appropriate steps to address those risks. Such actions **may include declining to participate in the transaction, or conditioning its participation upon the receipt of representations or assurances from the customer that reasonably address the heightened legal or reputational risks presented by the transaction.** The statement also establishes that a financial institution **should decline to participate in an elevated risk CSFT if, after conducting appropriate due diligence and taking appropriate steps to address the risks from the transaction, the institution determines that the transaction presents unacceptable risk to the institution or would result in a violation of applicable laws, regulations, or accounting principles.**”

NY Ins Dept Circular on Finite Reinsurance. March 2005

http://www.dfs.ny.gov/insurance/circltr/2005/cl2005_08.pdf

References

(2 of 4)

- “Road to Ruin – How insurance companies fail” by Professor Alan Punter, The Insurance Institute of Luton and St Albans, 29 Sept 2015
<http://www.localinstitutes.cii.co.uk/media/2888/luton-cii-talk-29-09-2015.pdf>
- Presentation at CAS Spring Mtg May 6, 2009 by Dan R. Young, Esq., Attorney at Law: Actuarial Accounting: A Cautionary Report
<https://www.casact.org/education/spring/2009/handouts/young.pdf>
- From caranddriver.com: “[General Motors](#) and [Toyota](#) had their massive scandals. Now it’s [Volkswagen’s turn](#). The company, which owns 70 percent of the U.S. passenger-car diesel market, is in major trouble for cheating on diesel-emissions tests. After years of promoting “Clean Diesel” as an alternative to hybrid and electric vehicles—the company even [marched on Washington with a squadron of Audi TDI models](#)—Volkswagen is stewing in its own toxic vapors.”

References

(3 of 4)

- VW lingering headline headaches
 - Fraud charge as reported in May 3, 2018 NYTs.
https://www.nytimes.com/2018/05/03/business/volkswagen-ceo-diesel-fraud.html?emc=edit_na_20180503&nl=breaking-news&nid=47847018ing-news&ref=headline
 - NYTimes.com headline from 28 June 2016 “\$14.8B fine just the beginning for Volkswagen”
 - VW took over top VW sales of cars in 2016 despite scandal due largely to China where they sell few diesel cars (The Guardian, <https://www.theguardian.com/business/2017/jan/30/vw-diesel-emissions-scandal-volkswagen-audi-porsche-skoda-Toyota>)
 - From <http://ewn.co.za/2017/03/21/vw-emissions-scandal-could-spread-to-south-africa> “**VW emissions scandal could spread to South Africa** Lawyer Damon Parker says the lawsuit is about ethics with people feeling cheated.”
- https://en.wikipedia.org/wiki/HHH_Insurance
- https://en.wikipedia.org/wiki/The_Equitable_Life_Assurance_Society
- <https://www.economist.com/finance-and-economics/2017/09/07/a-year-on-wells-fargo-cannot-shake-off-its-mis-selling-scandal>

References

(4 of 4)

- Comment on side letter quoted from <http://ritholtz.com/2009/04/aig-before-cds-there-was-reinsurance/>

“In the regulatory world, a ‘side letter’ is perhaps the most insidious and destructive weapon in the white-collar criminal’s arsenal. With the flick of a pen, underhanded executives can cook the books in enormous amounts and render a regulator helpless.”

Fraud Magazine