Institute and Faculty of Actuaries, Regulatory Board

Subject	Actuarial issues arising out of Liability Driven Investments (LDI)
Meeting date	25 July 2023
Previous Steer/Approval	16 November 2022 – Board update 21 February 2023 – further Board update
International issues considered?	UK only
Author	David Gordon, Senior Review Actuary Hannah MacLeod, Senior Regulatory Lawyer
Reviewer	Ben Kemp, General Counsel
Purpose	Approval

A: Executive summary

1. Following the update provided to the Regulatory Board ('the Board') at its February 2023 meeting, the Executive has analysed how the Actuaries' Code informs the work of members carrying out working in relation to Liability Driven Investments ('LDI') strategies. The Board is invited to approve potential regulatory steps following this analysis:
   - Amend non-mandatory guidance
   - Publish blog or news article discussing LDI work in context of the Actuaries' Code
   - Encourage Professional Skills Working Group to prepare materials relevant to LDI
   - Continued wider regulatory engagement
   - Prepare material for another regulatory event
2. This paper also provides a summary on the further steps that have been taken by regulators and others in relation to LDI strategies subsequent to those outlined in the February Board paper, in particular the recent report from the House of Commons Work and Pensions Select Committee.

B: Background

3. As described in previous Board updates, the IFoA took various steps following the fallout from the use of LDI strategies arising from the volatility in UK gilt markets following the UK Government's mini budget in September 2022. These steps included: participating in discussions with the Joint Forum for Actuarial Regulation ('JFAR'), consideration of a Risk Alert, and submission of a response to the House of Commons Work and Pensions Select Committee inquiry.

C: Responses of regulators

4. We have listed below the further steps taken by regulators and others subsequent to those listed in the February Board paper:

5. Following the Work and Pensions Select Committee's further call for evidence, an additional evidence session was held on 22 March 2023. Among those giving evidence was Laura Trott, Pensions Minister.
6. On 29 March 2023 the Bank of England's Financial Policy Committee ('FPC') published a paper 'LDI minimum resilience – recommendation and explainer' which set out recommendations on steady-state minimum levels of resilience for LDI funds, and contains more detail on the Bank staff's assessment of resilience. The headline recommendation was for The Pensions Regulator ('TPR') to take action as soon as possible to mitigate financial stability risks by specifying the minimum levels of resilience for the LDI funds and LDI mandates in which pension scheme trustees may invest. In particular, the FPC judged that the size of the yield shock to which LDI funds should be resilient should be at a minimum around 250 basis points (ie 2.5%).
7. In response to the FPC paper, on 24 April 2023, the Financial Conduct Authority published 'Further guidance on enhancing resilience in Liability Driven Investment' and TPR published guidance on 'Using leveraged liability-driven investment'. These focussed on the appropriate levels of resilience, the operational procedures to be adopted and ensuring that these continued to function in times of market stress.
8. The Work and Pensions Select Committee's report was published on 23 June 2023. The report's main themes are the need for more systematic, regular and comprehensive collection of data on LDI and the need to improve governance throughout the investment chain. Among the recommendations were:
   - DWP and TPR should improve the regulation of trustees and standards of governance, including considering whether the use of LDI should be restricted based on a test related to a trustee boards' ability to understand and manage the risks involved
   - The Government should bring investment consultants within the FCA regulatory perimeter
   - DWP and TPR should pause the introduction of the revised funding regime, pending a full impact assessment, including the impact on open pension schemes
   - DWP and TPR to report back to the Committee on progress on various matters by the end of October 2023.

D: Actuaries' Code analysis

9. The Executive has carried out a review into LDI matters, to explore further potential steps that the IFoA might take to address any issues and support members working in this area. This has focused on how the Actuaries' Code informs the work of members, whether they are advising pension scheme trustees, working for asset managers providing LDI investment products, or are themselves acting as pension scheme trustees. The paper examines each provision of the Code and provides example behaviours where members working in different roles in relation to LDI may be impacted.
10. The results of this review, are set out in the attached paper. These suggest that various provisions of the Actuaries' Code are directly relevant to members, whichever role they play in

the use of LDI strategies. The example behaviours outlined in the paper, can be summarised into five broad themes, along with the relevant Code provisions:

A. Ensuring most appropriate investments are chosen
B. Ensuring all parties understand complex investments and the implications of extreme scenarios via timely and clear communication
C. Ensuring operational processes kept up to date to respond in event scenarios materialise
D. Showing candour in the event that things go wrong
E. Avoiding conflicts of interest

11. Although a number of practical aspects of LDI are cited in this note, its purpose is not to comment on technical matters, in particular the influence of the Technical Actuarial Standards (TASs), on the work of actuaries in this area.

12. This has been a 'desk-top' exercise looking at the aspects of the Actuaries' Code that appear to be relevant to the work of members working in various roles with LDI investment. It has not looked at the specific work carried out in practice or attempted a review of that work.

E: Potential further steps

13. The Board is asked to consider whether any action is appropriate in light of the analysis that has been carried out.

14. The table below sets out a number of next steps, which the Executive recommends to be appropriate. These draw upon the Regulatory Tools outlined for the February 2023 Board meeting.

Recommended next steps		Comment
1.	Amend non-mandatory guidance	Re-visit non-mandatory guidance to include further material / examples to make clear link to behaviours relevant to LDI work, for example showing candour and considering relationships between advisers if things go wrong. However, as with existing guidance, this would be non-technical in nature and be drafted in general terms to apply to future situations.
2.	Publish blog or news article discussing LDI work in context of the Actuaries' Code	Opportunity to highlight changes to Code guidance (1 above) and demonstrate relevance of Code principles to range of LDI roles and be forward-looking

Recommended next steps		Comment
3.	Encourage Professional Skills Working Group to prepare materials relevant to LDI	Aimed at provoking discussion of the responsibilities of members in different roles. For example, discussion of appropriate actions when there's been an error and different parties have different interests This may include supportive materials, eg quizzes, Q&As, facilitation packs
4.	Continued wider regulatory engagement	IFoA continues to engage with TPR and FRC on regulatory actions, although these are typically technical in nature.
5.	Prepare material for another regulatory event	Opportunity to take materials from 2 and/or 3

15. For context, the Executive also considered the following regulatory actions but does *not* believe these are appropriate at the current time:

Other potential next steps		Comment
6.	Publish Risk Alert	Board already decided not to publish a Risk Alert on this, given actions by other (market) regulators which have a more direct role in LDI. More appropriate to focus on changing non-mandatory guidance and publicising those changes.
7.	Update education material	The Core Reading for subjects SA7 (Investment and Finance Advanced) and SA7 (Pensions Advanced) respectively already contain material on LDI which has been updated at a high level to cover the events of September 2022. This is likely to be updated further in light of subsequent regulatory actions.
8.	Amend competency framework for existing PC	None of this work is specific to Scheme Actuary PC holders, unless they are also acting in the separate, non-reserved, role of investment consultant
9.	Amend an APS	APS P1 is relevant for actuaries working in pensions, including Scheme Actuaries and 'Other actuarial Advisers' (who may be investment consultants). Para 3.1 requires them to inform the trustees or each other if there is a matter requiring advice or they have concerns about the trustees or their advisers. There is no separate guidance on APS P1. Amendments to the Code guidance (1 above) may refer to APS P1. APS X2 is not specific to a particular type of work. The need for work to be reviewed has not been identified as a behaviour specific to LDI work.

Other potential next steps		Comment
10.	Further research / info gathering	This paper is the outcome of exec-led internal review of LDI. Could consider a deep dive from F&I or Pensions Board to provide further background, although Board may consider it already had enough information to proceed. These Boards may be asked for informal feedback in developing revised guidance.

E: Appendix

- Appendix 1 LDI behaviours analysis