

## Institute and Faculty of Actuaries, **Regulatory Board**

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| <b>Subject</b>                          | Risk management and horizon scanning                                      |
| <b>Meeting date</b>                     | 20 September 2023   |
| <b>International issues considered?</b> | Yes   |
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| <b>Reviewer</b>                         | Fiona Goddard, Interim Head of Regulatory Policy                          |
| <b>Purpose</b>                          | Steer   |

### **A: Executive summary**

1. This paper discusses the use of the Regulatory Board's ("the Board") Horizon Scanning Register and suggests some key areas on which the Board may wish to focus. The paper suggests how the Board may wish to align its consideration of the risks identified within the Horizon Scan, with its priorities for 2023/2024. The Horizon Scanning Register is provided at Appendix 1.
2. In light of the Board's discussion on its Regulatory Toolkit, this paper invites the Board to discuss how best to address the risks presented within the Horizon Scan.
3. In considering the Regulatory Toolkit Flowchart, the Board will wish to consider whether the measures set out below remain suitable and proportionate to the risks identified.

### **B: The Horizon Scan Register**

#### The current risks

4. The register currently lists six risks, three of which are categorised as High Risk, and three Medium Risk. This paper focusses on the three High level risks, summarised as follows:
  - Inadequate allowance for climate change risks in actuarial work;
  - Complex models being insufficiently understood or communicated;
  - Significant developments in pensions being inadequately managed.

#### Climate change

5. The Horizon Scanning Register notes the risk that actuaries inadequately reflect the risks of climate change in their work. Over recent years it has been increasingly recognised that climate change and sustainability issues represent a material risk to future economic conditions. The development of science and understanding in this area is fast moving. Most recently, the risk of climate change scenario modelling, and in particular, the risk of the financial services industry, including actuaries, underplaying future financial risk as a result of this modelling, has been highlighted ("The Emperor's New Climate Scenarios").

6. This risk is currently being addressed in a variety of ways:
  - The IFoA through its Sustainability Board has contributed to various industry studies into climate related risk and as a result, the Regulatory Board has issued a Risk Alert in 2022, alerting members to climate related risks. At this time, the Board considered whether mandatory regulation, in the form of an amendment to the Actuaries' Code was also required and it determined that, at that stage, it would be more proportionate to develop non-mandatory guidance. This guidance is in development, with the intention of publication by December.
7. The IFoA has various sources of learning on climate related issues available to members, from a curated library, to webinars, Professional Skills CPD content, blogs and a Lifelong Learning course.
8. As part of members' CPD requirements, a Reflective Practice Toolkit has been developed to assist members to identify their learning and development needs in relation to this topic.
  - The IFoA has an extensive thought leadership programme engaged in discussion on climate change issues, and has produced a range of materials available [in its sustainability hub](#).

#### Further regulatory mitigations

9. It is suggested that the publication of non-mandatory guidance should continue to be a priority and that the Board may wish to consider a further Risk Alert to reflect the risks identified in recent studies regarding the under-estimation of climate risk.

#### The use of complex models

10. As stated in the Horizon Scanning Register, this risk relates to the emergence of increasingly complex models and the use of Artificial Intelligence (AI) to deliver potential solutions for clients. Whilst it is important that actuaries embrace the opportunities presented by these developments, there is also a risk that unfair outcomes may result from inadequate communication of risks and uncertainties.
11. This risk is currently being addressed in a variety of ways:
  - A [Thematic Review](#) is underway to assess the use by actuaries of Data Science, including AI, and to identify any issues arising;
  - A [Risk Alert](#) has been issued to members in September to warn of the increased risk of employing AI techniques and urging members to ensure ethical and transparent use; to use clear communication; to exercise appropriate caution; and to consult the existing range of guidance on both technical and ethical standards.
  - [Guidance](#) on Data Science was published in 2021 providing case-studies and illustrative examples to help Members faced with ethical and professional issues or dilemmas when undertaking data science work.
  - [IFoA Lifelong Learning](#) offers a certificate course in Data Science in conjunction with Southampton Data Science Academy to provide an introduction to the use of data science techniques and their relevance to actuaries.

#### Further regulatory mitigations

12. Given the ongoing thematic review, it is suggested that it should be a priority for the Board to complete the review and assess its findings before considering whether mandatory regulation, additional, or updated, guidance, or further steps to influence members, ought to be invoked in 2024.

#### Pensions developments

13. The Horizon Scanning Register notes the risk of a number of significant developments in Pensions over a relatively short period of time. This includes regulatory driven initiatives such as the new funding code of practice, and fast-track funding, as well as the introduction of new collective pension products such as Collective Defined Contribution (CDC), Master Trusts, and Superfunds.
14. The risk is currently being addressed as follows:
  - The Board has considered and mitigated this risk in respect of Collective Defined Benefit Pensions by the introduction of a Practising Certificate for actuaries carrying out this role;
  - The AMS team has recently carried out a review looking at the quality of corporate pensions advice;
  - Further AMS activity is planned in relation to pension scheme design;
  - A number of pension firms are part of the IFoA QAS arrangement.

#### Further regulatory mitigations

15. The FRC is currently consulting on an updated TAS300 and the introduction of TAS310 (CDC). The Regulatory Board is engaged with this and will hope to influence the resulting standard. The Board may also wish to feed into the eventual scope of the planned AMS Thematic Review on pension scheme design (to take place in 2024). It may also be worthwhile to consider a deep dive in one of the areas outlined, with renewed engagement with the Pensions Board.

### **C: Discussion**

16. The Board is invited to discuss the areas of high risk noted in the Horizon Scanning Register and whether these areas are adequately reflected in the Board's priorities for the year.

### **D: Appendices**

- Appendix 1 – Horizon Scanning Register