



## 4.8 Effective Communication

### Hotspot Description

The risk that actuaries fail to adequately explain the risks and potential adverse outcomes to decision-makers or to others impacted by their actuarial work.

### Current Influences

In general, as actuaries work more and more frequently as part of multidisciplinary teams, there is a risk that their voice may not be heard or may be heard and interpreted incorrectly.

Some current examples are:

- Pensions Dashboard where actuaries need to ensure that commercial dashboards appropriately and consistently project the various forms of pension provision.
- Actuaries supporting audits need to ensure that they not only display appropriate professional scepticism but also that the main audit team understand and act on their input.
- As the world becomes ever more complex and interconnected, actuaries may need to ensure that they understand and appropriately reflect differing opinions and present their conclusions in ways that decision-makers and the public can understand.
- Actuaries working as Independent Experts on Schemes of Arrangement or Part VII transfers need to appropriately consider their readership and the need to balance clarity and detail in their reports.
- Actuaries involved with determining, calculating, and verifying the assets and liabilities of pre-paid Funeral Plan Trusts should communicate the results of their valuation and assessment clearly to ensure users of their actuarial work understand the limitations and uncertainty around the modelled results.
- IFRS 17, which will demand more interaction between actuaries, accountants, and finance.
- Actuaries involved in advising pension schemes' trustees and sponsoring employers on funding and investment strategies need to communicate the uncertainties associated with the key economic and demographic drivers, and the assumptions made.
- Actuaries advising in situations involving competing rights between pension schemes' members need to communicate clearly the implicit or explicit effect of any proposed course of action, or of judgements made, on favouring some individuals or groups against others.

All the above examples contain technical challenges, but they also contain communication challenges for actuaries to ensure that their analyses and advice is communicated effectively and fairly to the non-technical public.

## Key developments and JFAR member regulators' actions during 2020/21

The essence of actuarial work<sup>243</sup> involves building models to project an uncertain future based on what the actuary knows of the past and how the actuary anticipates changes. These models generally provide a financial picture of the projected future to enable people today who are managing the issues to take the best decisions they can.

However, by definition, these models project an uncertain future, and this creates a challenge to the actuary to ensure that the user of the actuarial work understands the limitations and the range of probable (or possible) future outcomes. Effective communication of the reasonable range of outcomes is at the heart of the value that the actuary can bring to society.

The challenge is particularly acute where the actuary is encountering new situations and the current environment is one of profound and fundamental change. For example, consumers may have low levels of knowledge regarding financial matters<sup>244</sup> or longevity, and it is essential that such concepts are clearly explained to them so that they can make informed decisions.

To qualify as an actuary, actuaries must pass an examination<sup>245</sup> designed to test their ability to communicate actuarial concepts to non-actuaries. It is important that actuaries maintain and continue to hone these skills post-qualification.

Most of the hotspots discussed in other sections contain within them the need for effective communication and the risks that may crystallise when communication is ineffective. In the paragraphs below are a few current major considerations.

## Climate-Related Risk

It is widely accepted that one of the most serious risks currently facing the world is that due to climate change. Whilst actuaries may not be at the cutting edge of the science of climate change, they bring a valuable capability. Actuaries are trained to understand and communicate the financial and human costs implied by climate change when modelling the future.

A report<sup>246</sup> published by the IFOA Climate Change Working Party in March 2019 considered the challenges to communicating the impact of climate change. Section 6.1 of that report states:

*"There are particular aspects of climate change that make the communication of its risks particularly difficult. Communicating risk is simple if you understand what the risk is. However, climate change is a 'wicked problem'."*

A wicked problem<sup>247</sup> "is a problem that is difficult or impossible to solve because of incomplete, contradictory and changing requirements that are often difficult to recognise. Moreover, because of interdependencies, the effort to solve one aspect of a wicked problem may reveal or create other problems."

The report details suggestions for how actuaries can engage people in taking action to mitigate the impacts of climate change, and how to communicate the uncertainty around the projected effects.

As noted in Climate-Related Risk (including Biodiversity) (Section 4.1, Page 8), although the major physical risks belong to the future, the financial costs of transition and the idiosyncratic<sup>248</sup> risks are anticipated to emerge in the short-term.

<sup>243</sup> [https://www.actuaries.org.uk/system/files/field/document/2018\\_01\\_15\\_TAS%20100%20guidance%20with%20specific%20case%20studies.pdf](https://www.actuaries.org.uk/system/files/field/document/2018_01_15_TAS%20100%20guidance%20with%20specific%20case%20studies.pdf) [Paragraph 4.9]

<sup>244</sup> <https://www.ucl.ac.uk/ioe/news/2018/mar/england-has-one-lowest-levels-financial-literacy-study-says>

<sup>245</sup> <https://www.actuaries.org.uk/cp3-communications-practice>

<sup>246</sup> <https://www.actuaries.org.uk/system/files/field/document/Climate-change-report-29072020.pdf>

<sup>247</sup> [https://www.wickedproblems.com/1\\_wicked\\_problems.php](https://www.wickedproblems.com/1_wicked_problems.php)

<sup>248</sup> Idiosyncratic risk: the risk that specific companies may be adversely impacted by a specific occurrence that does not affect the entire market systemically.

## Modelling

For annual periods beginning on or after 1 January 2023 IFRS 17<sup>249</sup> will change requirements for reporting reserves in financial statements. The numbers produced are well-defined, but it can be challenging to communicate what they represent.

The world is at a time when modelling is about to become much more complex. Machine Learning (ML) and Big Data are beginning to enable modelling in new and more granular ways. ML poses considerable challenges to understanding the model, communicating what the model is assuming, and communicating why the model is deemed fit for purpose. There is a risk that actuaries may not understand how the models arrive at the answers. In this circumstance the actuary will find it more challenging to communicate the inherent uncertainty<sup>250</sup> in the results.

The Sterling LIBOR<sup>251</sup> panels will cease at the end of 2021 (see Announcements on the end of LIBOR),<sup>252</sup> and any models which make use of this will need to use SONIA<sup>253</sup> instead. In March 2021 the PRA and the FCA jointly published a letter<sup>254</sup> which makes clear what the expectations are for the final phase of the transition. Actuaries will have a key part to play in communicating the effect of this transition to the various stakeholders including ensuring any impact on policyholders is understood and well managed.

## Commercial Pressures in General Insurance

This topic is discussed more-extensively in Impact of Undue Commercial Pressure (Section 4.7, Page 45). However, effective communication is at the heart of the issue along with robustness. When the actuary is challenged to recommend reserves that are below what the actuary considers to

be a reasonable level, responding requires the ability to communicate the nature of uncertainty in a way that is acknowledged and understood by the entity's decision-makers.

There has been concern about the level of commercial pressure applied on some actuaries in the Lloyd's market. The PRA has issued communications to syndicates to warn of the need for adequate reserving.

Letters from the PRA of November 2019 to Chief Executives<sup>255</sup> and Chief Actuaries<sup>256</sup> discuss the need for actuaries to ensure they are giving appropriate consideration to the uncertainty of model output and communicating that effectively.

## Pension Projections

Historically, engagement with annual pension update statements and projections has been very low. Over the last year simplified statements<sup>257</sup> have been developed to encourage recipients to be able to read and understand the current and projected values of their defined contribution (DC) pension schemes. This is particularly important with the advent of automatic enrolment and millions more individuals receiving and largely dependent on their DC pensions for their retirement income.

This is a welcome development, but it carries risks. Individuals may see projected numbers and assume that these represent an outcome upon which they can rely. A challenge to actuaries is to present the projections in consistent ways that can help individuals understand that the current values and projections are merely a point along a journey and that they need to understand the figures in the context of that journey, including a better understanding of how much more they might need to save for their retirement.

<sup>249</sup> <https://www.ifrs.org/issued-standards/list-of-standards/ifrs-17-insurance-contracts/>

<sup>250</sup> <https://www.frc.org.uk/getattachment/b8d05ac7-2953-4248-90ae-685f9bcd95bd/TAS-100-Principles-for-Technical-Actuarial-Work-Dec-2016.pdf> [Paragraph 5.5]

<sup>251</sup> <https://en.wikipedia.org/wiki/Libor>

<sup>252</sup> <https://www.fca.org.uk/news/press-releases/announcements-end-libor>

<sup>253</sup> [https://en.wikipedia.org/wiki/SONIA\\_\(interest\\_rate\)](https://en.wikipedia.org/wiki/SONIA_(interest_rate))

<sup>254</sup> <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2021/march/transition-from-libor-to-risk-free-rates.pdf>

<sup>255</sup> <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2019/letter-from-gareth-truran-pra-current-areas-of-focus-for-general-insurance-firms.pdf>

<sup>256</sup> <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2019/letter-from-james-orr-feedback-from-recent-pra-reserving-reviews.pdf>

<sup>257</sup> <https://www.gov.uk/government/consultations/simpler-annual-benefit-statements-for-workplace-pensions>

The emergence of the Pensions Dashboard has the power to transform the situation. Central to the Pensions Dashboard efforts is the derivation of the Estimated Retirement Income<sup>258</sup> (ERI). Once dashboards project a person's comprehensive pension values and allow the person to ask 'what if' questions, individuals will gradually assume more control over their pension savings and be able to make more informed decisions. In this environment communicating the nature of the uncertainty and the range of options available to the individual become critical.

It is important for actuaries to work closely with governments, regulators, and pension providers to ensure that their professional skills in projecting financial and demographic factors are used to help clearly communicate the key issues to consumers.

A working party of the IFoA has produced a paper<sup>259</sup> considering actuarial aspects of the Pensions Dashboard and the chair of that working party is included in the Money & Pensions Service<sup>260</sup> (MaPS) Implementation Steering Group for the Pensions Dashboard.

### Defined Benefit to Defined Contribution transfers

With a low interest rate environment transfer values are at historical highs. However, whether these high transfer values will mean that it is more suitable for an individual to transfer depends on many factors. Pension scheme members should receive communications that help them understand the relationship between transfer values and the benefits they would be giving up so they can make better informed decisions for their future.

The FCA has published a number of consultations<sup>261</sup> aimed at improving the quality of the (mainly mandatory) advice needed when transferring a DB pension. However, the consumer journey starts at their original DB

scheme. It is important that actuaries who work for pension schemes' trustees or sponsoring employers develop effective communication strategies so that pension scheme members do not take actions which may not be in their best interests.

### Advice on actuarial factors used in pension schemes

Actuaries advise pension schemes' trustees on setting actuarial factors which affect the benefits paid to pension scheme members. The IFoA completed a Thematic Review<sup>262</sup> in 2020 which highlighted the need for actuaries to prioritise sound rationale and clear communication. The report highlights that, when advising pension schemes' trustees, actuaries should focus on explaining the range of factors affecting calculations for transfer values and commutation rates and the reasons for the difference between the two.

### Scenario testing

Assessing the impact on a financial institution or pension scheme from adverse scenarios (of individual events or combinations of events) is now a key focus in regulation. Actuaries need to communicate to stakeholders: the reasoning for selecting the scenarios tested; that the scenarios are appropriately adverse; and the implications of the results of the scenario tests.

### A connecting theme

The theme that connects these examples is not just the communication of uncertain futures. In all the above examples the role of the actuary is to communicate the uncertainties in the model projections and results of scenario tests, taking account of the needs of all stakeholders. The actuary interprets what the alternative projections mean in the real-world future and therefore recommends a course of action designed to produce a desired outcome while mitigating the adverse impact of potential future risk.

<sup>258</sup> ERI = Estimate of the annual income the Individual might receive in retirement, in today's money terms.

<sup>259</sup> <https://www.actuaries.org.uk/system/files/field/document/The%20Pensions%20Dashboard%20An%20Actuarial%20Perspective%20%282%29%20-%20amends.pdf>

<sup>260</sup> <https://moneyandpensionservice.org.uk/>

<sup>261</sup> <https://www.fca.org.uk/publications/policy-statements/ps20-6-pension-transfer-advice-feedback-cp-19-25-final-rules>

<sup>262</sup> <https://www.actuaries.org.uk/system/files/field/document/Pensions-Thematic-Review...PDF>