HYMANS ROBERTSON

Setting objectives for investment consultants

What do the new CMA requirements mean for my scheme?

At the end of 2018, the Competition and Markets Authority ("CMA") published its report following a review of the investment consulting and fiduciary management markets. Earlier this year, following on from this review, the CMA issued an Order, setting out requirements for the appointment and governance of fiduciary managers, and for **Pension Scheme Trustees** to set objectives for their investment consultants.

Pension Scheme Trustees means the trustees or managers of Occupational Pension Schemes that have their main administration in the United Kingdom. The CMA requirements extend to both Trust-based schemes, and Local Government Pension Schemes (i.e. Pension Committees).

The remainder of this note focusses on the requirement for Pension Scheme Trustees to set objectives for their investment consultants.

What are the requirements?

The CMA has stipulated that **Pension Scheme Trustees** should set objectives for their investment consultants, and that such objectives should be:

1. 'closely linked' to the pension scheme's investment objectives
2. reviewed at least every three years, and after a significant change to the investment strategy or objectives
3. established no later than 10 December 2019 (i.e. 6 months following the date of the final Order published by the CMA) or prior to appointment of a new investment consultant

The CMA has set out specific actions that must be carried out by trustees using fiduciary managers. We can provide separate guidance addressing these requirements should this be relevant for your scheme.

The importance of objectives

We have been strong advocates for establishing long term objectives as part of a well organised and well managed governance approach.

Provided that appropriate resources are allocated to support longer term goals, having clear, structured and measurable objectives can greatly enhance the chances of long term success for your scheme.

The extension to set objectives for investment consultants could be regarded as a natural progression towards all stakeholders being aligned towards a common goal. Indeed, we believe that best practice would be to establish objectives for all key service providers supporting Pension Scheme Trustees in achieving their longer-term goals, not just your investment consultants.

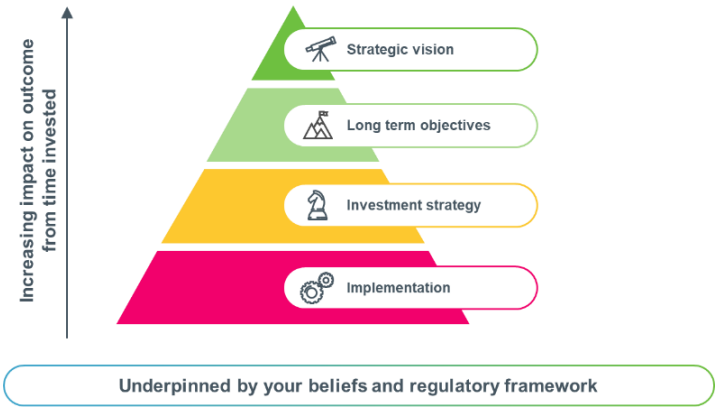
Establishing objectives for consultants

In their accompanying explanatory note, the CMA states that objectives for consultants should include a clear definition of the outcome expected, and timescales for achieving this. In addition, objectives should be measurable thereby supporting reporting to Pension Scheme Trustees.

Your funding and investment objectives will reflect your strategic vision and specific circumstances.

And so the objectives for your investment consultant should equally be tailored to reflect this.

We envisage that such objectives can be set in the context of the governance model illustrated.



By way of an example, a pension scheme may have the following long-term investment objective:

- *"Achieve the returns from investments to meet the long-term funding objective whilst keeping risk within acceptable levels to support stable and affordable contributions from the employer".*

For DC schemes, this might also reference *"improving member outcomes based on designing an investment strategy within acceptable risk levels."*

A corresponding objective for investment consultants may be:

- *For DB schemes, to "Provide advice on the investment strategy to deliver a target net return of XX% over gilts on the scheme's investments with as little risk as possible, in order to support full funding by 20XX and stable and affordable contributions from the employer."*
- For DC schemes, *to "Provide strategic investment advice that will maximise investment returns while recognising and taking account of the changing risks that members face as they progress towards retirement."*

In addition to strategic advice, trustees will typically look for their consultant to provide advice around the implementation of the strategy. This might be captured by objectives around the following:

1 Effectiveness of strategy to meet cashflows and liquidity requirements

2 Effectiveness and efficiency of implementation of the strategy

Other broad areas that we believe you may wish to capture in the objectives, but which are less directly measurable, include:

3 Efficiency in the governance of the strategy

4 Provision of regulatory updates and meeting compliance requirements

5 Monitoring of the strategy and its implementation

6 Quality and timeliness of advice to enable timely, informed decision making

Measuring success

One of the key challenges of measuring success is that many methods and metrics for assessing performance are typically short-term in nature and can be unhelpful for the purpose of measuring 'success' of long-term objectives. In some cases, these methods and metrics could lead to counterproductive decisions and hence hinder success when not considered in the context of what trustees are trying to achieve over the long term.

Trustees should align the measurement of investment consultants to appropriate time periods. Based on the example above, such measures for DB schemes may include:

- *Strategy*: measure over rolling 5 year periods, the contribution from the investment strategy toward achieving the agreed long term strategic targets, and the extent to which progress has remained within expected tolerances given the agreed risk profile.
- *Implementation*: measure over rolling 3 year periods the return on the Scheme's assets relative to the Scheme's composite benchmark return and target return, net of fees.

For DC schemes, the measure could be defined as:

- use realised returns on sample members to assess whether the investment strategy is working as intended and that the right level of risk is taken at the right time as members approach retirement.

Reporting compliance

As set out in their Order, the CMA has established that those subject to the new requirements should report on their compliance on an annual basis. This covers both the adherence to setting objectives for consultants and assessing the extent to which investment consultants are on track to meet those objectives.

In addition to this, if applicable, Pension Scheme Trustees will also be required to report on the appointment and governance of fiduciary managers.

Pension Scheme Trustees will be required to submit their first round of compliance reporting no later than **12 months and 4 weeks** after the date that the relevant requirements came into force. This translates into a deadline of early January 2021.

On 29 July 2019, the Department for Work and Pensions ("DWP") released its consultation to turn the CMA's requirements into legislation. As part of their draft legislation, the DWP has specified that trustees (excluding LGPS) would be expected to report compliance annually via the Pensions Regulator's scheme return.

The Ministry for Housing, Communities and Local Government is expected to clarify how the requirements will translate to the LGPS.

Next steps

Pension Scheme Trustees should establish objectives for their consultants no later than **10 December 2019**. Your Hymans Robertson Consultant will be in touch to provide guidance for setting these objectives and helping ensure that you meet your obligations under the Order.

HYMANS ROBERTSON
CLUB VITA

London | Birmingham | Glasgow | Edinburgh T 020 7082 6000 | www.hymans.co.uk | www.clubvita.co.uk