



Report of the Section 151 Officer

Local Pension Board - 24 September 2020

Competition and Markets Authority (CMA) – Setting Objectives for Investment Consultants

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| Purpose: | To appraise progress against the agreed objectives for appointed investment consultants as required by CMA requirements. |
| Policy Framework: | To comply with CMA requirements. |
| Consultation: | Legal, Finance and Access to Services. |
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| Legal Officer: | Stephanie Williams |
| Access to Services Officer: | Rhian Millar |
| For Information | |

1 Background

1.1 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 (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) to set objectives for their investment consultants.

2 What are the requirements?

2.1 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 strategic 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.

3 The Importance Of Objectives

- 3.1 Establishing long term objectives is 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
- 3.2 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

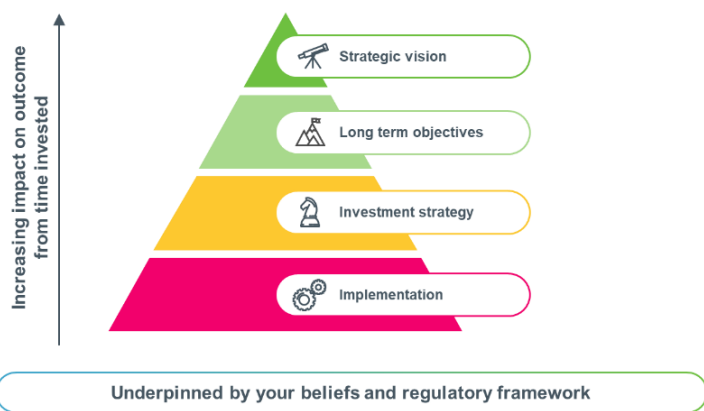
4 Establishing Objectives For Consultants

- 4.1 In their accompanying explanatory, 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.



- 4.2 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”.*

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.”*

4.3 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:

- Effectiveness of strategy to meet cashflows and liquidity requirements
- 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:

- Efficiency in the governance of the strategy
- Provision of regulatory updates and meeting compliance requirements
- Ongoing monitoring of the investment arrangements
- Quality and timeliness of advice to enable timely, informed decision making

5 **Measuring Success in Practice**

5.1 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.

5.2 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.

6 **Reporting Compliance**

6.1 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.

- 6.2 In addition to this, if applicable, Pension Scheme Trustees will also be required to report on the appointment and governance of fiduciary managers.
- 6.3 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.
- 6.4 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 Pensions Regulator is also consulting on draft guidance, focussing mainly on how trustees should assess the performance of their investment consultants relative to objectives.
- 6.5 The Ministry for Housing, Communities and Local Government is expected to clarify how the requirements will translate to the LGPS.
- 6.6 The Pension Fund Committee approved the performance objectives at Appendix 1 at its March 2020 meeting. Evaluation of performance against those objectives is also presented at Appendix 1.

7 Legal Implications

- 7.1 There are no direct legal implications arising from this report

8 Financial Implications

- 8.1 There are no financial implications arising directly from this report.

9 Equality and engagement Implications

- 9.1 There are no equality implications arising from this report

Background Papers: None.

Appendices: Appendix 1 - Investment Consultant Performance Objectives.

Investment Consultant Performance Objectives

| 1 | | Demonstration of value added advice services | Services/advice provided by Hymans during 2020, falling under the relevant objective |
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| | 1.1 | Help the trustee to implement an investment strategy which adds value through the integration of ESG (including climate change) and stewardship considerations in their investment manager appointments | <ul style="list-style-type: none"> • Carbon footprinting exercise taking place during Q2/Q3 2020, in context of 2022 target. (Ongoing work on potential Russell overlay; possible removal of EM) • Ongoing review of ESG policy, and potential broadening of the scope • Recent commitments to mandates with explicit ESG-focus/impact include BMO, Man Group, BlackRock Renewables • Comments provided on developing BlackRock low carbon equity to involve exclusions |
| | 1.2 | Enable the Pension Fund Committee to access a wider range of opportunities and portfolios of assets (and/or build portfolios of assets) | <ul style="list-style-type: none"> • Advice provided on new opportunities with BMO, Man Group and Blackstone |
| | 1.3 | Assisting the Committee in setting well-defined strategic objectives for the Fund: <ul style="list-style-type: none"> - Achieving full funding with an acceptable degree of risk - Ensuring sufficient liquidity of assets to meet pension cashflows | <ul style="list-style-type: none"> • Strategic objectives for the Fund are stated in the ISS (last reviewed March 2018), and recent Actuarial Valuation (Aon) confirmed current investment strategy provides the Fund with high likelihood of meeting its objectives. Review of ISS to take place in Q4 2020/ Q1 2021 (3 year review). |
| | 1.4 | Providing strategic advice to ensure a strategy consistent with Fund's objectives | <ul style="list-style-type: none"> • Ongoing advice has been provided on new investments, to ensure these are consistent with strategy agreed in 2017-18 (move towards Enhanced Yielding assets). |
| | 1.5 | Advising on cost-efficient implementation of the investment strategy at all times <ul style="list-style-type: none"> • | <ul style="list-style-type: none"> • Hymans raised the possibility of carrying out a cost transparency exercise earlier in the year. This exercise is being carried out by the Wales Pension Partnership ('WPP') as we understand. |
| 2 | | Delivery of specialist | |

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| | | services | |
| | 2.1 | Help the Pension Fund Committee to decide on an appropriate risk and performance objectives | <ul style="list-style-type: none"> As new investment managers are appointed, appropriate performance objectives are set for each mandate and we have commented on these in our due diligence advice. These objectives/ benchmarks are then reflected in our quarterly reporting for the Fund. In addition, a liability benchmark return is provided to assess how funding is expected to have moved. |
| | 2.2 | <p>Help the Pension Fund Committee to decide' in consultation with key stakeholders, to do the following:</p> <ul style="list-style-type: none"> to help the Pension Fund Committee to develop and define their investment beliefs, ESG Policies, RI Policies, Voting Policies to help the Pension Fund Committee to review their investment governance arrangements and terms of reference for any subcommittees or delegated authorities | <ul style="list-style-type: none"> Review of ESG policy, and potential broadening of the scope is ongoing No sub-committees currently are in operation. National Knowledge Assessment indicated a possible need for training on performance assessment and benchmarking, which the Deputy Chief Finance Officer is considering. |
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| | 3 | Proactivity of advice | |
| | 3.1 | Advise the Pension Fund Committee on new investment opportunities or emerging risks | <ul style="list-style-type: none"> Hymans provided email updates to Officers during Q2 2020 in response to market volatility and risks. Suitability notes in respect of the following funds have been provided year to date: <ul style="list-style-type: none"> Blackstone's Strategic Capital Holdings CVC Partners Private Debt Man Group's Community Housing Fund BMO's UK Housing Fund |
| | 3.2 | Advise the Pension Fund Committee on market pricing opportunities to mitigate or manage risk | |
| | 3.3 | Deliver training to enable the Pension Fund Committee to engage with new investment | <ul style="list-style-type: none"> We have not provided any training on new asset classes. National Knowledge Assessment indicated a high-level of |

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| | | opportunities, emerging risks or opportunities to manage risk | understanding amongst Committee, with possible need for training on performance assessment and benchmarking, which the Deputy Chief Finance Office is considering. |
| | 3.4 | Advise on any changes in the investment governance arrangements or delegated authorities which are necessary to enable the Pension Fund Committee to best access the emerging opportunities | <ul style="list-style-type: none"> • Ongoing advice provided on transfers to WPP. Fixed Income transfers have recently been delayed. • We have worked closely with Officers to advise on new mandates efficiently and then bring these to Committee |
| 4 | | Support with member engagement and communication | |
| | 4.1 | Through the use of communication and behavioural techniques, help the Pension Fund Committee effectively engage with their membership to better understand their needs | <ul style="list-style-type: none"> • Nothing provided on this area year-to-date. |
| 5 | | Support with scheme management and compliance | |
| | 5.1 | On a regular (quarterly) basis, monitor the performance of the scheme's investment strategies and also the performance of the scheme's investment managers | <ul style="list-style-type: none"> • Regular quarterly investment report provided and discussed at each Committee meeting, along with any relevant advice. |
| | 5.1 | Produce investment reports, briefing papers and investment advice in advance of trustee meetings and on a timely basis | <ul style="list-style-type: none"> • All papers provided to the Committee within the timescales agreed with the Deputy Chief Finance Officer and agendas are agreed in advance. |
| | 5.3 | Assist the Pension Fund Committee with the review and update as appropriate the scheme's Investment Strategy Statement | <ul style="list-style-type: none"> • The Fund's ISS was last updated in March 2018, so is due to be reviewed in Q4 2020/Q1 2021 (3 year review). |

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| | 5.4 | Provide periodic written advice on any direct investments held | <ul style="list-style-type: none"> No specific advice provided in this area, as there has not been the need. |
| | 5.5 | Provide trustee training as required | <ul style="list-style-type: none"> No dedicated training has been provided year-to-date. National Knowledge Assessment indicated a possible need for training on performance assessment and benchmarking, which the Deputy Chief Finance Officer is considering. |
| | 5.6 | Ensure compliance of the scheme's investment arrangements with the regulations | All arrangements remain compliant, and we would advise if otherwise. The Fund's ISS will need to be reviewed ahead of March 2021. There have been no recent regulatory changes that we needed to make the Fund aware of. |
| 6 | | Relationship and service standards | |
| | 6.1 | Agree any changes of (named) investment consultant(s) and meeting covers with the Deputy Chief Finance Officer in advance | <ul style="list-style-type: none"> Hymans' team and those attending meetings has remained stable with no recent changes. |
| | 6.2 | Maintain fees in line with tender submission | <ul style="list-style-type: none"> Hymans' fees are in line with tender submission, with fixed fees for certain core tasks, and time-cost fees for additional tasks. Project fees of £5k or over, are agreed in advance with the Deputy Chief Finance Officer. |
| | 6.3 | Agree fee budget with officers for any significant piece of work | <ul style="list-style-type: none"> See 6.2 |
| | 6.4 | Clear understanding of the scheme's goals and objectives | <ul style="list-style-type: none"> This has been demonstrated through the continued implementation of the Fund's 'Enhanced Yielding' portfolio and the suitability review of mandates to ensure they meet the objectives of the Fund. |
| | 6.5 | Appropriate quality and quantity of resourcing to meet the needs and requirements of the scheme | <ul style="list-style-type: none"> Any work or request have been dealt with in a timely manner, with exception of the carbon footprinting exercise that was delayed due to MSCI data issues. |
| | 6.6 | Strong positive working | <ul style="list-style-type: none"> We continue to enjoy working with |

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| | | relationship with the Pension Fund Committee | officers and the Committee, and believe the relationship remains strong. |
| | 6.7 | Appropriate conflicts of interest or management and mitigation of any conflicts | <ul style="list-style-type: none"> The potential conflict, and subsequent mitigations put in place, as a result of Hymans' role as an oversight advisor to the WPP was flagged to the Deputy Chief Finance Officer earlier this year. No further conflicts to report. |
| 7 | | Support with additional matters arising | |
| | 7.1 | Provide advice and assistance to the Pension Fund Committee on any other investment issues arising (for example following court rulings affecting the scheme) | <ul style="list-style-type: none"> Recent correspondence on the potential impact on the Fund of the RPI reform (RPI aligning with CPIH between 2025 and 2030), although potential impact would appear low. |
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