

Consultation response

# Guides to deliver the CMA's recommendation to produce guidance to trustees of occupational pension schemes on engaging with investment consultants and fiduciary managers

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## Introduction

The Competition and Markets Authority (CMA) has introduced new duties for trustees and managers of occupational pension schemes, which will take effect from 10 December 2019. The CMA recommended that we produce guidance to support trustees in complying with these new duties. We consulted on this guidance between 31 July 2019 and 11 September 2019.

We received 33 responses from representative and professional bodies, trustees, investment consultants, fiduciary managers and advisers. A full list of respondents is included in the Appendix. We are grateful to everyone who responded to our consultation. This document summarises feedback we received and changes we have made to the guidance as a result.

## The consultation

We published the following guides as part of the consultation:

- A trustee guide to choosing an investment governance model.
- A trustee guide to tendering for fiduciary management services.
- A trustee guide to tendering for investment consultancy services.
- A trustee guide to setting objectives for providers of investment consultancy services.

We invited views on the following:

- Clarity around our use of language when setting out the new requirements and examples of good practice.
- The competitive tender process and whether any areas were missing.
- Proportionality and reasonableness of applying the principles of a competitive tender process.
- Clarity on how to apply the principles of a competitive tender process when selecting a provider of investment consultancy services.
- Usefulness of case studies in the guide to setting objectives for providers of investment consultancy services and whether any other examples could be used.
- Effectiveness of the balanced scorecard for measuring performance on providers of investment consultancy services and any alternative methods that could be applied.
- Features that would support trustees in selecting an appropriate investment governance model.

# Comments received and our response

## 1. A guide to tendering for fiduciary management

### We asked

- **Question one: Is the language used in the guidance clear and unambiguous? If not, what would provide clarity?**
- **Question two: Do you consider that there are any areas of a competitive tender process missing?**
- **Question three: Are the key principles of running a tender exercise reasonable and proportionate? In particular, are there any scheme types or sizes for which the principles would not be reasonable and proportionate?**

### You said

The majority of respondents thought the guidance was clear and useful in setting out the legal requirements and good practice in meeting those requirements. However, a small number of respondents commented on the volume of guidance published and expressed concerns about being able to find key information in the guidance. A significant minority also provided comments on a number of key areas:

#### Definition of fiduciary management

A number of respondents highlighted that there is some confusion in the market about whether certain delegated governance models meet the CMA's definition of fiduciary management. One respondent also said it is particularly unclear how the definition of fiduciary management translates for defined contribution (DC) schemes.

#### Timing

A small number of respondents suggested it would be helpful to include further explanation on when trustees will be required to complete tender exercises. This would be particularly useful for schemes with existing fiduciary management arrangements that must run a tender exercise within five years of the appointment having been made.

#### Reasonable endeavours

We received a number of comments relating to the term reasonable endeavours. Suggestions included a clearer definition from us, outlining the tasks required to achieve a valid bid and examples of how trustees can demonstrate compliance.

#### Taking a flexible and proportionate approach

There were mixed responses in relation to the proportionality of applying the principles of a competitive tender exercise. Some respondents found the principles useful and flexible enough for trustees to adopt depending on their circumstances. However, a number of respondents suggested we make it clearer in our guidance that the principles should be applied proportionately, and it is not a 'one size fits all' approach.

## 1. A guide to tendering for fiduciary management

Some respondents thought site visits may not be appropriate in all circumstances and that if they are built into the process, trustees should have a clear agenda and use these visits for the purposes of further developing their operational due diligence. Longlisting was considered unnecessary by some if using a third party. It was also suggested that smaller schemes might only need to conduct a desk-based process with presentations.

### Early engagement with providers

Some respondents said that early engagement between the trustees, employer and potential providers ahead of formal invitations to tender was an important step, and that it should have more prominence in the key principles of a competitive tender. While some stated this was particularly important for smaller schemes, others felt it was good practice for schemes of all sizes and complexity. Concerns were raised regarding market capacity to manage the anticipated increase in invitations to tender. It was felt that encouraging trustees to contact providers early in the process would enable providers to identify genuine tenders and increase trustees' likelihood of receiving at least three bids to meet the legal definition of a competitive tender for a fiduciary management appointment.

### Our response

We recognise that the four guides cover a lot of material. It is important that trustees understand their new duties and the impact this can have on scheme and member outcomes. The scope of the guidance focuses on the CMA's recommendations for us to support trustees in meeting their new duties and benefiting from the full set of remedies. We chose to produce the short guide on choosing an investment governance model to address some of the gaps in knowledge and understanding. These were gaps the CMA identified as part of its investigation and that we were aware of through our own engagement with trustees on investment governance.

The final guidance will be published as a series of web pages (rather than PDFs), which have been designed to improve readability and accessibility. We hope the new format will help trustees to more easily navigate their way through the guidance and enable them to click through to the most relevant content for their needs.

### Definition of fiduciary management

We note the concerns raised about the scope of the definition of fiduciary management. However, these are matters for the CMA and the Department for Work and Pensions (DWP). If trustees and providers are unsure if their arrangements are captured, they should seek their own advice.

We recognise that the use of fiduciary management for DC assets is currently limited and that the market is still emerging. We also recognise that there is confusion around how the management of DC assets is captured by the definition, and concern that some trustees may not (currently) be able to obtain bids from three fiduciary managers.

In order to meet the legal requirement, trustees must make reasonable endeavours to achieve bids from three unconnected fiduciary management providers. However, to undertake a meaningful tender and to enable them to select an appropriate investment management arrangement for their scheme, trustees do not have to limit their selection exercises to just fiduciary management.

## 1. A guide to tendering for fiduciary management

Trustees can also consider including providers, who offer an alternative approach to DC provision and which may (or may not) have some similar features to fiduciary management. This will enable them to select an appropriate arrangement for their scheme through their tender exercise, and taking account their trust law duties, it may be appropriate for them to do so. We have amended our guidance to include some considerations for trustees of DC schemes.

### Timing

For trustees of schemes with existing fiduciary management arrangements, we have included some examples to illustrate how to determine the deadline for running a competitive tender exercise. However, we would expect trustees to consider whether it would be appropriate for them to begin the tender process sooner, to allow sufficient time to prepare and run the process effectively.

### Reasonable endeavours

In relation to the definition of reasonable endeavours, this is a familiar term in a contractual context and “reasonable” is itself commonly used in legislation. Providing a definition of this term is out of the scope for our guidance and it would be inappropriate to try to give a definitive interpretation. However, we have set out some considerations for trustees. We would expect trustees to set out what steps they believe to be reasonable and proportionate for their scheme and which might be appropriate to increase the likelihood of receiving three bids. This is likely to vary from scheme to scheme. We set out in our guidance that trustees should document the process they follow, and the basis on which they conclude they have completed a meaningful tender which meets their requirements under the regulations.

### Taking a flexible and proportionate approach

We agree that trustees should apply the principles of a competitive process proportionately to the circumstances of their scheme. We have amended the guidance to make this clearer. The principles are intended to be a guide for trustees in designing a process that will enable them to obtain comparable bids which meet the needs of their scheme and will inform decision-making.

We accept the comments regarding site visits. These may not be appropriate in all circumstances (particularly for schemes with limited scale) but they may be a useful tool when trustees need to decide between competitive bids and before making a final decision to appoint a particular fiduciary manager. Again, it is a matter for the trustees to consider if it is reasonable for them to build this into their process. We have amended the guidance so this is included as an option when deciding between providers.

### Early engagement with providers

We acknowledge respondents’ views on this matter and have increased its prominence in the principles of a tender exercise. We acknowledge that some smaller schemes may find it more challenging to obtain bids from providers. It is for trustees to determine how they wish to structure this early engagement, whether that is a telephone call, exchange of emails or an expression of wish submission.

## 2. A guide to tendering for investment consultancy services

### We asked

- **Question four: Is it clear how trustees can apply the principles of a competitive tender exercise to the selection of a provider of investment consultancy services?**

### You said

Again, the majority of respondents thought it was clear how to apply the principles of a tender exercise to the selection of a provider of investment consultancy services. The same themes of applying the principles flexibly and proportionately and the value of early engagement with potential bidders emerged. Additionally, the following themes were raised.

#### Legal status of the guidance

Some respondents commented that the CMA did not mandate tenders for investment consultancy providers and some were unaware of the CMA's recommendation for us to produce this guidance in their final report. There was therefore some confusion regarding legal duties in this area and a call for us to make it clear to trustees that there is no legal requirement underpinning this guidance.

#### Conflicts of interest

It was noted by some respondents that while conflicts of interest are covered in this guidance, they were not as prominent as in the guide to tendering for fiduciary management services and that the drafting should follow this approach more closely.

### Our response

Regarding the themes of using proportionality when applying the principles of a competitive tender and considering early engagement with providers, we have made amendments as we did in the guide to tendering for fiduciary management services.

#### Legal status of the guidance

In its final report, the CMA recommended that we produce guidance for trustees on applying a competitive tender process to the selection of providers of investment consultancy services. We make clear in the guidance that it has been produced in response to the CMA's recommendation and that its purpose is to provide examples of good practice.

#### Conflicts of interest

When drafting the four guides, we were mindful to keep repetition of content to a minimum whilst still enabling each guide to stand alone. We recognise that the guide to tendering for fiduciary management services covered conflicts of interest in greater depth. We have therefore expanded the section on conflicts of interest in this guide to include examples of some specific conflicts trustees should be aware of when selecting providers of investment consultancy services.

### 3. Setting objectives for providers of investment consultancy services

#### We asked

- **Question five: Is the language used in the guidance clear and unambiguous? If not, what would provide clarity?**
- **Question six: Are the case studies useful in illustrating the elements of services trustees should consider setting objectives in relation to? Do these present an accurate representation of how trustees may set objectives for their investment consultants? Do you have any other examples that could usefully be included to demonstrate the different approaches that schemes of different sizes, and with varying available resources, might take to comply?**
- **Question seven: Is the example balanced scorecard an effective way to assess the performance of providers of investment consultancy services? Are there alternative methods trustees could use?**

#### You said

##### Alignment with DWP regulations and clarity on legal requirements

A small number of respondents highlighted that our draft guidance did not always align with the DWP's draft regulations. For example, the guidance references the definition of investment consultancy services used in the CMA Order which differs to the one proposed by the DWP. One respondent also highlighted that the draft regulations set out that investment consultant's performance against objectives should be reviewed every 12 months, but the guidance sets out that it is good practice to review at least every three years. This respondent commented that there is potential for confusion in this area.

More generally, some respondents noted that further clarity was needed on the distinction between the legal requirements and good practice. There was a call from a few respondents to set out which services must have objectives set and which service should have objectives set to support good governance. One respondent also noted that further clarity regarding how the guidance applies to local government pension schemes (LGPS) would be welcome.

##### Scheme actuaries

A significant number of respondents raised concerns regarding the application of the duty to set objectives for scheme actuaries. The CMA Order includes an exclusion of the high-level commentary from scheme actuaries and the DWP have consulted on draft regulations which do not include this explicit exclusion on the grounds that they consider it is clear that this has no practical possibility of meeting the definition of investment consultancy services. In relation to the guidance, respondents are particularly concerned that we suggest that advice from the actuary may be investment consultancy services and that this should be removed to provide reassurance that typical actuarial commentary would not fall within the definition.

#### Application of the balanced scorecard and proportionality

Respondents generally found the example balanced scorecard to be useful, but a small number raised concerns that it may be interpreted as a template. Others thought it was overly complex, time intensive and might not be appropriate for smaller schemes. One respondent said that some consultancy firms will develop their own assessment templates.

#### Setting measurable objectives

A small number of respondents suggested that further guidance on how to decide on weightings for the objectives and how to apply scores was needed. Others commented that, while the example balanced scorecard was a simple and effective way to demonstrate how to set objectives, unless they are set using 'SMART' principles, measuring these will be very subjective. One respondent also said it was important to stress that trustees should set a balanced range of objectives, recognising that the role of the investment consultant is to balance risk and return. This respondent also suggested there was a risk that some trustees might focus too heavily on investment returns and/or funding levels, which would not be appropriate measures in isolation.

#### Aligning investment consultant objectives with the trustees' scheme objectives

A few respondents commented that the guidance does not include how the objectives set for investment consultants link back to supporting trustees in achieving their objectives for the scheme. It was suggested that we include understanding the trustees' own objectives for the scheme as a first step before considering objectives for their investment consultants

### Our response

#### Alignment with DWP regulations and clarity on legal requirement

We note the concerns regarding possible misalignment with the DWP regulations. Until the DWP regulations are made and the sunset provisions of the CMA Order applied, trustees and scheme managers of LGPS funds are required to comply with the CMA Order. Our guidance therefore focuses on supporting compliance with the CMA Order. Once the DWP regulations come into force in 2020, we will make the necessary amendments to ensure references to legal duties are consistent with pensions legislation.

In relation to providing further clarity on what services are captured by the legal requirement and which services should have objectives set, we have made some amendments to the guidance to highlight that the Order requires objectives to be set for the services listed in (a) to (d) of the definition of investment consultancy services. However, our guidance is not intended simply to be an interpretation of the law and we have therefore also provided a list of services which meet that definition.

### 3. Setting objectives for providers of investment consultancy services

Trustees will need to use their judgement and seek advice if they are unsure which services must have objectives set for them. We expect, as a matter of good governance, that trustees would consider the full range of services that they receive and whether it is appropriate to set objectives even where there is no direct legal obligation to do so. In certain cases, failure to consider to any extent whether it might be appropriate/helpful to set objectives, could be evidence to support a conclusion that the trustees have failed to ensure there is an effective system of governance or that the trustees do not have the required level of trustee/pension board knowledge and understanding.

#### **Scheme actuaries**

We recognise the concerns raised in this area. An explicit exclusion for the high-level commentary of a scheme actuary is a matter for the DWP to consider as part of their consultation. In relation to our guidance, we have made some amendments to note that the CMA Order excludes high level commentary from an actuary. However, we continue to reference that the scheme actuary, along with other advisers, may provide investment advice as examples of where trustees will need to consider and/or seek advice as to whether they are captured by the legal requirement to set objectives.

For example, a scheme where there is no investment adviser and trustees simply rely on the actuary to assist in investment decisions would clearly not be within the exemption for such investment advice. Our view is that it is good practice for trustees to have a process in place to measure the performance of all advisers and service providers to ensure they are meeting the objectives for the service, delivering value for money and are performing their delegated activities in line with the trustees' requirements.

#### **Application of the balanced scorecard and proportionality**

As noted under our comments on the guide to tendering for fiduciary management above, we have made some minor amendments to the guidance to make it clearer that trustees should consider an approach that is proportionate to the circumstances of their scheme. The example balanced scorecard is not intended to be a template but to illustrate how trustees may approach the exercise of setting objectives.

We recognise that some third parties and consultancy firms are likely to develop their own templates. The example in our guidance may be a useful starting point for those trustees looking to develop their own assessment. It can also be a point of reference when trustees are considering the framework suggested by their advisers. If investment consultants are working with trustees to set and agree their objectives, we would remind trustees that it remains the trustees' duty to set the objectives. They should satisfy themselves that the objectives being set meet the legal requirement and support their measurement of an appropriate level of performance and value for money.

#### Setting measurable objectives

The intention of the example balanced scorecards is to give trustees an overview of the range of objectives that could be set to cover the broad range of services that investment consultants provide. The example objectives provide a balance between quantitative and qualitative assessments and encourage trustees to consider the value added by the investment consultant.

#### Aligning investment consultant objectives with the trustees' scheme objectives

Our guide to choosing an investment governance model includes a section on understanding the long-term objectives for the scheme before choosing an appropriate governance model. We agree that the services received from an investment consultant and how performance and value for money is measured should link back to those objectives. We have therefore amended the guidance to include a section on understanding the objectives for the scheme in advance of setting objectives for investment consultants.

## 4. A guide to choosing an investment governance model

### We asked

- **Question eight: The guide to choosing an investment governance model describes the key features of investment consultancy and fiduciary management. Are there any other features missing which would support trustees in deciding on a suitable model for their scheme?**

### You said

Not all respondents commented on this guidance however of those that did, a number highlighted the following themes:

#### Choosing a governance model is not binary

Respondents generally understood the aim of the guidance and considered it to be a useful start in highlighting key areas to consider. However, there was some concern that the guidance was presenting the use of investment consultancy and fiduciary management as a binary choice and that there was the need for greater recognition of the spectrum of delegations that can exist between these models.

#### The example fiduciary management model

Many respondents felt that the use of a partial fiduciary management model in the example was potentially confusing and recommended that it was simplified to a full fiduciary management model, to make the comparison between the two ends of the delegation spectrum clearer.

Some respondents considered that strategic asset allocation (SAA) should be delegated to the fiduciary manager. Some said that trustees should decide the level of return required and the level of risk that can be tolerated and the strategic asset allocation decisions could then be delegated. Others said that this is the most important decision which should be taken by those with the highest expertise.

### DC schemes

A small number of respondents thought this guidance had a strong defined benefit (DB) focus and there was a danger that trustees of DC schemes may consider this guidance irrelevant. Recommendations included highlighting services that may be more commonly used by DC and DB schemes and highlighting fiduciary management in a DC context.

## Our response

### Choosing a governance model is not binary

The intention of this guidance was to address issues of knowledge and understanding regarding investment governance models. We recognise that there are a wide variety of approaches that trustees could adopt for their investment governance and that there is a spectrum of delegation that can exist between investment consultancy and fiduciary management. We have amended the introduction to the guidance to make this clear and have included a short description of some alternative options. However, we do not intend to provide an exhaustive list of options that trustees can consider and have focused on the two ends of the spectrum.

### The example fiduciary management model

We have chosen to simplify the example to a full fiduciary management arrangement but retained the brief description of how this may differ in a partial fiduciary arrangement and the role of the investment consultant.

In relation to delegating SAA decisions, trustees are responsible for preparing a Statement of Investment Principles and, in accordance with regulation 2(3)(b)(ii) of The Occupational Pension Schemes (Investment) regulations 2005, the trustees must include their policy relating to the balance between different kinds of investments. Whilst the trustees must seek written advice from an appropriate person and consult the employer, ultimately this must be a decision for the trustees in any investment governance model. However, matters as to strategic asset allocation beyond that may be delegated and we recognise that fiduciary managers are likely to make day-to-day decisions regarding asset allocation in line with the parameters set by the trustees..

### DC schemes

There is currently no consistent industry view of what fiduciary management looks like for DC schemes and that market is still emerging. For these reasons, the guidance may appear to be more DB focused in relation to describing fiduciary management. We have provided some considerations for DC schemes throughout the guidance. As noted earlier in this response, we have made some changes to our guide on tendering for fiduciary management in relation to DC fiduciary management and we have set out an approach that may be appropriate for DC schemes to ensure a meaningful tender is conducted.

## Appendix: List of respondents to the consultation

Association of Consulting Actuaries (ACA)  
ACMCA Limited  
Aon  
Association of Professional Pension Trustees (APPT)  
Barnett Waddingham  
Bfinance  
Buck Consultants  
CFA Society UK  
EY  
First Actuarial  
Hyman Robertson  
IC Select  
Institute and Faculty of Actuaries (IFoA)  
Kempen  
KGC Associates Ltd  
KPMG  
Law Debenture  
LCP  
Mercer  
Muse Advisory Limited  
Northern Ireland local government officers' superannuation committee (NILGOSC)  
OPDU  
Pensions and Lifetime Savings Association (PLSA)  
Pensions Management Institute (PMI)  
Principles for Responsible Investing (PRI)  
PS Governance Services  
Redington  
River and Mercantile Investment Limited  
Derek Scott  
The Society of Pensions Professionals (SPP)  
Squire Patton Boggs  
UK Power Networks Group of the ESPS and UK Power Networks Pension Scheme  
Willis Towers Watson

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