A trustee guide to:

Tendering for investment consultancy services

July 2019

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Introduction

This guide has been produced in response to the Competition and Markets Authority's Investment Consultants Market Investigation Final report[1] and their recommendation that we provide guidance for pension scheme trustees on choosing and monitoring providers of investment consultancy services.

This guide aims to provide you with practical information and key matters to consider when putting together a competitive tender exercise to appoint a provider of investment consultancy services.

We discuss the duties introduced by the Competition and Markets Authority's Investment Consultancy and Fiduciary Management Market Investigation Order 2019[2] ('CMA Order') in our **guide to setting objectives for providers of investment consultancy services**.

This includes matters to consider when monitoring your adviser. In relation to the duties in the CMA Order, the term 'investment consultancy services' has a specific meaning. For the purposes of this guide, we discuss investment consultancy more generally.

1 https://assets.publishing.service.gov.uk/media/5c0fee5740f0b60c8d6019a6/ICMI_Final_Report.pdf
2 https://assets.publishing.service.gov.uk/media/5cfdfa86e5274a090f9eef8e/Order_investment_consultants.pdf

Appointing an investment consultancy provider

When an investment consultant is appointed in an advisory-only role, the strategic investment decisions are taken by the trustees following advice from the investment consultant. The day-to-day investment decisions (such as which individual investments to hold) are delegated to the investment managers, who have been appointed by the trustees following advice received from their investment consultant.

This governance model is often suitable where the arrangements are not overly complex and trustees have sufficient time and expertise to make timely investment decisions when required, or when the trustee has an investment sub-committee.

There can be variations of this governance model and in some cases investment consultancies will offer their clients a hybrid service, whereby they will undertake a very limited range of actions once certain pre-determined triggers are met. Similarly, for some schemes, existing investment managers will agree to undertake certain investment and risk management actions within clearly defined parameters set by the trustees in advance, once certain triggers and thresholds are met.

When you are considering appointing a provider of investment consultancy services, it is good practice to consider running a tender exercise before making the appointment, as with any other provider of services to the scheme. A competitive tender exercise will help you identify the adviser that best matches your scheme's objectives and your requirements for the service. It may also help you put in place a more favourable fee structure for services you receive.

When appointing an investment consultant, you should be aware of the potential for a wide range of conflicts of interest to arise. Conflicts of interest should not be a barrier to appointments or decisions being made. However, you should ensure that appropriate measures are in place to identify, mitigate and manage those conflicts.

Further information about managing conflicts of interest can be found in our **conflicts of interest guidance** and **guide on scheme management skills**.

Key considerations when tendering for investment consultancy

Understanding your governance capabilities

The requirements you will have for your investment consultancy service provider will vary depending on your scheme governance structure and capabilities. Before preparing a tender for an investment consultancy provider, it is good practice to consider:

- the level and extent of investment expertise available to your trustee board through the board membership, the investment sub-committee and any in-house or executive team, and
- the time available to perform your investment duties.

If your current scheme governance structure and circumstances give rise to a concern, you should consider whether changes are necessary. This could include the following:

- Appointing a professional trustee (or an additional professional trustee) with specific skills and experience in relation to investment.
- Creating an investment sub-committee.
- Reviewing the extent of delegated authority provided to the investment sub-committee to enable decisions to be made and implemented.
- Expanding your board and sub-committee roles, for example by increasing the membership or increasing the time commitment needed to perform those duties.

Where you are concerned that you may not have the necessary investment expertise or governance capabilities within the board, you may wish to consider delegating those activities to optimise investment outcomes.

Your investment beliefs

As a trustee board, you should establish a set of core investment beliefs as these can help focus and improve the effectiveness of your investment decision-making.

These beliefs can also help you set more appropriate objectives for the selection and appointment of your service providers and help you identify the most appropriate investment governance model for your scheme and trustee board.

If as a board you do not understand or have enough experience to agree your investment beliefs, you should seek advice from your existing service providers and/or consider appointing an independent third party adviser with specific investment experience, who will be able to assist you.

Your scheme objectives

As a trustee board, you should also establish a set of core investment objectives for your scheme, as these will influence which governance model will be most appropriate for your scheme and support the development of your selection criteria for any tender exercise.

After appointing your new investment adviser, you should review and develop your beliefs and objectives with them.

For further information on investment beliefs and objectives, see our **DB investment guidance** and **DC guide to investment governance**.

Key principles of a competitive tender process

When designing a tender exercise, it is good practice to consider the following key principles:

1. **Set objectives for the tender exercise:** Understand what you want from a provider and how this will meet the objectives for your scheme. Make sure you have re-assessed your scheme objectives. They should be based on current analysis, relevant to your scheme circumstances and enable your longer-term objectives for the scheme to be delivered.
2. **Seek advice and consider appointing a third party to assist you:** You may wish to consider using a third party to provide advice on the selection process. This will help manage conflicts of interest, provide in-depth insight into the current market and save time and resource in putting together a tender exercise. It will allow you to focus on the key decisions.
3. **Understand the full range of market opportunities:** Understand the different options in the market and create a list of potential providers based on your objectives and criteria for selection. If you are using a third party, they will be able to support you in developing a longlist based on their market knowledge, research and due diligence.
4. **Select longlist of potential providers:** Based on your review of the market, select a sub-set of providers and create a longlist to invite to tender. If you are not using a third party, you may find it useful to send an expression of interest inquiry to potential providers, setting out some high level details of your scheme, your potential mandate requirements and including a number of preliminary questions to gather relevant information to enable you to develop your longlist to invite to tender.
5. **Agree criteria for selection:** Be clear on what you are looking for in a bid and decide in advance how you will assess providers. Consider putting together a scorecard, weighting matters based on their level of importance in meeting the objectives you set for the tender exercise.
6. **Issue invitations to tender:** Invitations to tender should focus on requesting a bespoke offering from providers that will support you in meeting the objectives you have set for the tender exercise. The invitation to tender should include a brief overview of your scheme's current arrangements and set out the requirements for the service you are seeking.

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When designing a tender exercise, it is good practice to consider the following key principles continued…

7. **Assess bids and select a shortlist:** Using your scorecard, compare the bids based on your agreed criteria and select a shortlist of candidates to consider in more detail.

8. **Invite shortlisted providers to present their proposals:** The shortlisted providers should be invited to present to the trustees. This will provide you with the opportunity to interview the candidates and to discuss the services they propose to offer in greater depth.

9. **Site visits:** Conduct site visits with the final two to three providers as part of your overall due diligence or with your preferred provider, before confirming any appointment.

Investment consultancy tender example

Below is an illustrative example of how these principles can be applied to a tender exercise for an investment consultant.

Scheme background

The trustees of the XYZ pension scheme had retained ABC Investment Consultants as their investment advisers for many years and had also retained, for a significant period, their scheme actuary, administrator, lawyer and covenant adviser.

The XYZ pension scheme was a DB/DC hybrid pension scheme comprised of the following:

- A closed and rapidly maturing DB section which was 80% funded on a technical provisions basis and 60% funded on a buy-out basis.
- The scheme investments were invested across a range of mainly traditional asset classes, equities, bonds and property, with some alternatives and some leveraged liability driven investment (LDI) which hedged 50% of the liabilities interest and inflation rate exposures.
- An open and rapidly growing DC section, including a default arrangement using a combination of passive funds and a range of six actively managed funds that members could self-select.

An experienced independent trustee was recently appointed as chair of trustees following a selection process. The new chair was committed to reviewing and re-tendering the services provided by all the scheme's current advisers and believed that the investment adviser role should be the first to be re-tendered.

Reviewing investment governance capability

Following a short period of review, the new chair acknowledged that the individual trustee board members had a significant range of relevant skills but was concerned that the composition of the scheme's sub-committees was sub-optimal and that although the main trustee board functioned, its performance could also be improved. Consequently, the chair, with the support and funding from the employer, engaged an independent third party, PQR, to:

- review their existing scheme governance, including the roles and responsibilities, how the trustee board and individual sub-committees functioned, how decisions were made and how the trustee board and sub-committee membership might evolve in the future
- help them, in conjunction with a workshop organised by their existing investment consultant, to:
  - clearly define their investment beliefs
  - scope out and define their objectives for the scheme over different time horizons (which involved their scheme employer's participation for some of the time), and
  - review the extent certain responsibilities are delegated to different sub-committees and service providers.

Following the initial review and receipt of a report from PQR, the trustees (with the support of the employer) agreed to revise the structure and terms of reference of their sub-committees and to re-tender for their investment consultancy service. The trustees then asked PQR to run the tender process for them and agreed that their current investment adviser should also be invited to tender.

The trustees were comfortable using PQR as they believed they had the skills, resources and experience necessary to assist them with an investment consultant selection exercise and as they had provided evidence (and references) for a number of previous investment consultancy tenders they had run for DB and DC schemes.

Preparing the specification

Based on the work PQR had previously done with the trustees, they put together a high-level specification for the selection exercise which captured the trustees' beliefs and general requirements for the appointment. This included the following:

- Active management and investment in illiquid and alternative investments could add value, if the manager selection (and, where relevant tactical asset class rotation) was done by individuals with the expertise, skills and resources necessary to be able to effect decisions on a timely basis.
- Investing responsibly and engaging as long-term investors reduces risk over time and may impact scheme returns positively.
- Unrewarded risks should be hedged, diversified or transferred over the medium to longer-term as the funding level in the DB scheme is expected to recover. The investment consultant, working with the scheme actuary should be able to explore opportunities to effect a liability risk transfer for segments of the membership by way of an insurance company buy-in.
- Understanding members' circumstances and characteristics was important to maintaining an appropriate investment strategy within the DC section.
- The range of investment options offered should allow for different member needs (cash, income and annuity).
- The DC scheme's default arrangement should generate returns significantly above inflation while members were a long way from retirement and switch gradually into lower risk investments as members neared retirement.
- The DC investment arrangements offered to members should provide value for members and help to deliver good member outcomes over the long-term.

Deciding who to invite to tender

Using this specification, PQR mapped the trustees' high-level requirements against the full range of providers of investment consultancy services available in the market place. This also allowed for some additional features such as the impact of the scheme scale and allowing for their market knowledge relating to high-level business issues (scale of firm, loss of staff, loss of mandates, quality of investment advice and research etc). PQR then produced a brief report setting out a longlist of eight potential investment consultancy firms, with a brief outline of each of the firms.

PQR discussed their report with the trustee and the differences and similarities between the eight investment consultancy firms on the longlist. They also outlined, at a high level, some of the key strengths and weaknesses of each of the potential providers. Following discussion, the trustee agreed to invite five of the investment consultancy firms to formally tender.

The tender process

As PQR had extensive knowledge of the investment consultancy market, they were able to rely on their existing research and ratings of investment consultancy firms to provide some of the inputs into the trustee briefing papers. To supplement this information they prepared a brief invitation to tender which set out the following:

- The scheme background and the trustees' reasons for tendering.
- The trustees' high-level requirements for the tender.
- The expected timeline for the tender and implementation.
- The contact details for the chair of the trustee (to enable an introductory conversation).
- The PQR contact details for specific queries relating to the tender submission.

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The tender process continued...

They also included a series of questions within the invitation to tender, for example a request to provide details of the following:

- Their firm, their areas of expertise and relevant experience of similar DB, DC and hybrid arrangements.
- The individuals who would be directly responsible for their scheme.
- How they propose to interact with the trustee, frequency of meetings, level of training.
- Their ability to successfully identify and select investment opportunities, together with supporting evidence.
- The investment and risk monitoring reports they would produce for the trustees.
- Their views on the current DB and DC investment arrangements and how they might be modified or developed to enable an improved outcome to be delivered.
- The range of analytic techniques, individual modelling tools, communication and behavioural strategies they used to support member engagement and identification of member needs for DC schemes.
- Their proposed fee structure (including any performance fee structures) and level of fees and expenses that they would expect to apply to the fund. To enable the trustees to compare fees on a consistent basis, the firms were asked to provide a breakdown of their fees against a schedule of the services that the trustees expected to be delivered.
- Trustees of a number of other DB, DC and hybrid schemes they worked with, that would be prepared to provide references.

The five investment consultancy firms were given four weeks to respond to the invitation to tender and five responses were received.

Reviewing bids and making a decision

PQR assessed and graded the individual submissions between 1 and 5 (1 = poor, 5 = excellent) against a weighted scorecard agreed with the trustees. The scorecard was broadly based on the following in Table 1 below :

Table 1: Example of a scorecard that can be used when assessing tender submissions

Requirements based on:	Weighting	Score (1-5)
Firm, scale resources	10%	
Responsible individuals	10%	
DC capability	10%	
Proposed interaction	10%	
Manager selection/asset allocation	10%	
Monitoring reports	10%	
Investment/strategic views	30%	
Fees, implementation, references	10%	
Total	**100%**	

Please note: This example is for illustrative purposes only. Weightings should be bespoke to your scheme's requirements.

The trustees had a good understanding of investment consultancy and the range of services offered, and decided to invite two investment consultancy firms to present to them.

PQR invited the two shortlisted consultants to present to the trustees and requested that, as part of their presentation, they include their preliminary recommendations for the scheme's future investment strategy and set out how they would propose to implement that strategy. The agenda allowed time for each consultant to present and for the trustees to ask questions, followed by time for the trustees to review and assess after each presentation.

Following the presentations, the trustees identified their potentially preferred provider but felt that given the scale of their scheme, they might not get the level of support and service that a larger scheme or a flagship scheme might get. They asked their preferred provider to confirm in writing the team that would be responsible for dealing with the trustees on an ongoing basis and to provide a copy of their proposed service agreement, including the terms and conditions.

Following review and advice being received from their scheme lawyer and PQR, the trustees agreed to appoint their preferred provider. PQR then prepared a brief document setting out the process the trustees had gone through, which set out the key decisions and the main reasons why those decisions were taken.

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www.tpr.gov.uk

www.trusteetoolkit.com
Free online learning for trustees

The Pensions Regulator

A trustee guide to:
Tendering for investment consultancy services