

Consultation on tougher rules on investment governance

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Introduction

On 29 July 2019, the DWP issued a [consultation](#) on draft regulations (“the Consultation” and “the Regulations” respectively) imposing new obligations on trustees in relation to the fiduciary management and investment consultancy services they receive.

Key points

- The Consultation and Regulations are designed to integrate into pensions law an [order produced by the CMA](#) following its investigation into the investment consultants market (“the Order”), and will enable TPR to oversee the new requirements.
- In future, trustees will need to carry out a competitive tender process for fiduciary management (“FM”) services if their scheme uses such arrangements for at least 20% of their funds. Transitional provisions apply where an FM appointment is already in place. Trustees will also be required to set strategic objectives for their investment consultancy (“IC”) provider.
- Quite separately, fiduciary managers and investment consultants will also have new reporting obligations relating to charges, fees and performance, to make it easier for trustees to compare providers effectively.
- Whilst the Regulations are not scheduled to come into force until 6 April 2020, the CMA’s Order will take effect on and from 10 December 2019, and so will apply to pension schemes in the interim.
- On 31 July 2019, TPR published a [consultation](#) on a suite of guidance aimed at supporting trustees in meeting their new duties and engaging with their providers.

Background

Following a reference from the FCA, the CMA carried out a market investigation into FM and IC services to pension schemes. FM involves the delegation by trustees of some investment decisions to advisers. In broad terms, IC is the provision of advice to trustees on investment strategy and related matters.

The CMA’s [Final Report](#) highlighted the importance of FM and IC services to their main customers, pension

scheme trustees, helping them to manage over £1.6 trillion of investments on behalf of scheme members. Noting that it is “vital that competition within these markets works well”, the CMA concluded that there is an adverse effect on competition in the two markets “from which substantial customer detriment may be expected to result”. The CMA also identified difficulties for trustees in gaining access to the information needed to evaluate the quality of existing consultants.

As a consequence, the CMA proposed remedies to encourage improved trustee engagement when buying both FM and IC services, as well as the provision of better and more comparable information on fees and performance.

The Order: obligations for trustees

With effect from 10 December 2019, the Order will:

- require pension scheme trustees who wish to delegate investment decisions for 20% or more of their scheme assets to run a competitive tender when first purchasing FM services
- require pension scheme trustees who have already appointed a fiduciary manager (or managers) for 20% or more of their scheme assets without a tender, to put the service out to tender within five years of the appointment. If the five-year period has already expired, or will do so within two years of the date on which the Order was made (10 June 2019), the tender must instead be run before the end of a two-year period beginning with the date of the Order, ie before the end of 9 June 2021
- prohibit trustees from entering into a contract with an IC, or from continuing to obtain IC services from an IC, unless they have set the IC strategic objectives.

Scope of the Regulations

The Regulations will apply to occupational pension schemes established under trust, other than:

- schemes which are not registrable
- executive pension schemes
- public service pension schemes
- relevant small schemes (ie certain schemes with fewer than 12 members)
- unregistered schemes with fewer than 100 members.

In addition, the following schemes will also be excluded from the requirement to carry out a competitive tender for FM services:

- schemes where the principal or controlling employer, or a connected company (broadly, a company in the same group) provides FM and / or IC services to the schemes
- schemes whose trustee(s) provide FM and / or IC services to the scheme
- master trusts for which an IC-FM firm (or a connected IC-FM firm) is the scheme strategist or scheme funder.

The DWP considers that it would be impractical, in the above circumstances, to expect the scheme trustees to carry out a competitive tender for FM. However, it believes it is reasonable for the trustees to set their IC

objectives and to monitor performance against them.

Mandatory tendering for FM

Like the Order, the Regulations require trustees to carry out a “qualifying tender process” (or to arrange for such a process to be carried out on their behalf), before appointing an FM provider, or increasing the amount of assets managed by an FM provider, where either would result in the “asset management threshold” being met for the first time.

A “qualifying tender process” means “the process of:

- inviting, and using reasonable endeavours to obtain, bids for the provision of the relevant FM services from at least three unconnected persons, and
- evaluating the bids which are obtained”.

The “asset management threshold” is met if 20% or more of the “manageable assets” of the scheme (the assets, excluding buy-in policies) are managed by FM providers.

Setting objectives for ICs

In setting objectives, the trustees must have regard to their SIP. The Regulations will require trustees to:

- set objectives for each IC provider (except one who is a scheme trustee or a company wholly owned by the scheme trustees)
- review and, if appropriate, revise an IC provider’s objectives at least every three years and without delay after any significant change in investment policy.

The DWP refers to “objectives” rather than “strategic objectives” (as in the Order) “to avoid the unintended perception that only objectives relating to investment strategy should be included”. Any objectives set under the Order for existing ICs will be treated as set under the Regulations when they eventually come into force on 6 April 2020.

In the Consultation, although not forming part of the Regulations themselves, the DWP also notes that it expects the objectives to:

- include a clear definition of the outcome expected to be delivered and the timescale over which it will be delivered
- be relevant to the services provided, and
- enable the trustees to measure the performance of the IC services provided.

TPR’s guidance

In its Final Report, the CMA recommended that TPR produce guidance to support trustees in complying with the new duties, as well as to assist trustees in tendering for IC services. TPR is now [consulting](#) on the following documents:

- a draft guide to tendering for FM – providing a set of key principles to illustrate a good practice approach

to tendering and outlining how these may be applied to tendering for FM

- a draft guide to tendering for IC – using an illustrative case study, this shorter guide aims to outline how the key principles of a competitive tender may be applied to a tender for IC
- a draft guide to setting objectives for providers of IC – setting out the matters to consider when setting objectives and monitoring progress, and including case studies to illustrate how this might be applied by DB and DC schemes
- a draft guide to choosing an investment governance model – which aims to support trustees in understanding their investment governance capability, and highlights key matters to consider when deciding on an appropriate level of delegation. TPR considers this to be an important step before deciding to tender for services.

References to the new duties in the guidance currently relate to the Order. Following the Consultation, these will be updated to reflect the final version of the Regulations.

Next steps

The Consultation on the Regulations closes on 2 September 2019, with TPR's consultation on the guidance ending on 11 September 2019.

Whilst the Regulations are not scheduled to come into force until 6 April 2020, the CMA's Order will take effect on and from 10 December 2019, and so will apply to pension schemes in the interim. Trustees should therefore start preparing for the new requirements.

If you have any questions on any of the above, **please speak to your usual Sackers contact.**

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