

How schemes should be acting after CMA review

As schemes grapple with new fiduciary management and investment consulting rules, **Charlotte Moore** asks what trustees need to do

AT A GLANCE

- ❖ Schemes can find comfort in using 'reasonable endeavours', once that is defined
- ❖ Trustees must ensure a fair trial when holding a tender process for fiduciary managers
- ❖ It may be necessary to speak with advisers before setting investment objectives for them

In June the Competition and Markets Authority (CMA) issued a legally binding order in a bid to help pension trustees make better decisions, marking the final step of its reform of the investment consultancy and fiduciary management sectors.

Trustees, fiduciary managers and investment consultants have until 10 December to ensure their practices are in line with the order's requirements. If they do not comply with the order, the CMA could take them to court.

There are two key prohibitions on trustees from the CMA's final order. In some cases they are not allowed to appoint a fiduciary manager unless they have undergone a competitive tendering process. Nor can they continue to accept investment consultancy services unless they have set the provider some strategic objectives.

These recommendations are a result of the CMA's in-depth analysis into these sectors, which found significant concerns about competition.

Sackers partner Ian Cormican says: "The investigation was prompted by competition concerns since a small number of investment consultants had a controlling market share and their services were rarely reviewed."

There were concerns that investment consultancies, who had originally been providing advice, had

now established their own fiduciary management firms.

"They were effectively persuading clients to appoint them, then being appointed as a fiduciary manager as well as consultant, which arguably gave them an unfair advantage in those mandates," Cormican continues.

Competitive tenders

It is the requirement to hold competitive tender that could create the most upheaval. This requires trustees to invite and use reasonable endeavours to obtain written proposals from at least three independent fiduciary managers.

Then they must carry out a competitive tendering process, when that manager would be responsible for 20% or more of their assets. This includes where they have an existing mandate but where a tender process had not previously been conducted.

Such schemes have five years from the manager's original appointment and, if the five years have already expired or will expire within two years of 10 June 2019, then the tender has to be run by the 9 June 2021.

Cormican says: "One of the consequences of this new legislation is many schemes could be running competitive tenders at the same time."

The requirement to use reasonable endeavours means this must be a genuine project, he continues, noting: "Fiduciary managers need to put a considerable amount of resource into this process."

Some managers may choose not to compete for certain schemes if they feel they will not have a genuine opportunity and it would be a waste of resource, he adds.

Reasonable endeavours

Following the implementation of new regulations, expected in April 2020, The Pensions Regulator



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(TPR) will determine whether a scheme has undertaken 'reasonable endeavours'.

Cormican says: "If a scheme asks three managers to quote for the work but only receives a quote back from two then it might try to find a third quote but ultimately a scheme can only do what it can do."

Finding only two but not three quotes in these circumstances might be judged to meet the requirement of, he adds.

Pensions and Lifetime Savings Association (PLSA) policy lead for investment and stewardship Caroline Escott agrees: "If a scheme can demonstrate it had used 'reasonable endeavours' to find three proposals but could only find two quotes, this should be okay."

But it is not entirely certain exactly what 'reasonable endeavours' entails. This is the subject of some discussion among lawyers, Escott says.

"Trustees should speak to their lawyers to determine what 'reasonable endeavours' means for them in terms of how they should document their competitive tendering process," she adds.

The PLSA asked for a clearer definition of the term in TPR's recent consultation on guidance for the CMA order.

Escott says: "It would be helpful for trustees if there was greater detail about the practicalities involved in pursuing reasonable endeavours."

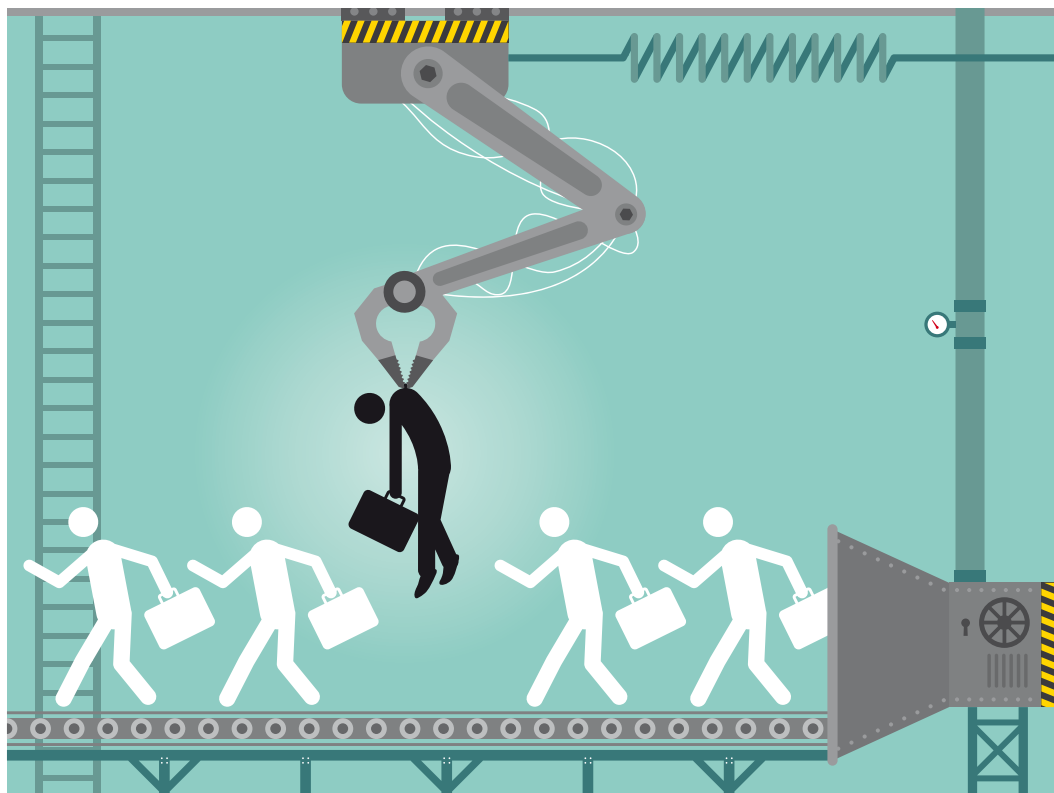
The legislation will also require trustees to understand which of their managers could be caught by the fiduciary manager definition.

Cormican says: "Schemes with their own enhanced investment functions need to consider whether they would understand why this would not be defined as a fiduciary manager." They will need to seek advice to make this decision, he adds.

This is also the case for large liability-driven investment mandates. If there is any advisory element to that strategy, they need to check this will not be caught by the definition.

Fair trial

These are not the only difficulties. Dalriada Trustees senior trustee representative Vassos Vassou says: "It may be challenging to run a



competitive tendering process that effectively puts the incumbent on trial."

Ensuring the project is fair to all participants will be tricky, he continues, adding: "Trustees will need to put their past knowledge to one side to make an informed and unemotional choice."

There are difficulties even for those schemes that are appointing their first fiduciary manager. Vassou says: "Trustees will need to find an accurate way to assess which managers provide good value for money and which ones do not."

While independent trustees are likely to have experienced multiple beauty parades and will be able to assess these managers' qualities with impartiality, other lay trustees may not have those skills.

Despite the potential short-term headaches created by the need for competitive tendering, the changes are welcomed.

BESTrustees trustee executive Steve Balmont says: "Trustees should seek guidance on the appointment of a suitable fiduciary manager and advice on setting the scope of work of the fiduciary manager."



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**Vassos Vassou,
Dalriada Trustees**

A competitive tender exercise helps identify and benchmark the manager best able to meet trustees' objectives and provides insight on how trustees might monitor and work with a preferred manager, Balmont adds.

Strategic objectives

While the requirements around fiduciary management can cause difficulties for both trustees and managers, it will only impact schemes using these services. But all trustees which use an investment consultant will have to set them strategic objectives.

Cormican says: "This will apply to most occupational pension schemes established under a trust – there are only a few very limited exceptions."

Trustees already have to set out their investment principles, in which they detail their appetite to risk, their asset allocation and how they take into account ESG issues.

Cormican says: "These will have to be taken into account when they set their objectives for investment consultants but they will need to take them further." TPR seems to be looking at this as a detailed governance exercise.

"In other words, these strategic objectives will require trustees to think about what they expect from their investment consultants, including what services they provide and how to measure them against those objectives."

Determining these strategic objectives is high on the agenda of many trustee meetings, Balmont says.

The requirement for these objectives was finalised at the end of July and needs to be set by 10 December 2019. Balmont says: "This short timescale means trustees may only have one, or possibly two, regular trustee meetings in which to come up with these objectives."

The challenge for trustees is how to start on drawing up a set of strategic objectives. Balmont says: "TPR's consultation contains case studies, which are a good starting point."

These case studies will, however, need editing to make them appropriate to the needs of each individual scheme. "There lies the challenge: how should trustees adapt these studies to draw up objectives that are fit for purpose?" he adds.

While it would defeat the object of the exercise if trustees were to invite investment consultants to set their own objectives, it is important to work with advisers.

Balmont says: "Trustees might start with the regulator's template but then they need to gather together all the information to identify the advice they are likely to need from their consultant."

This enables trustees to set parameters to determine how well an adviser is performing, how to monitor against their objectives, and guide action if they are failing, he adds.

With limited time available, trustees should not become obsessed with perfection. Balmont says:

"This will be an iterative process and should stimulate a dialogue between the scheme and its advisers." Over time, these objectives can be finessed as trustees gain greater insight.

"Documenting process is a good discipline that I strongly support," says Balmont. It should give more clarity when evaluating adviser performance, which in the past may have been driven more by intuition. ■