Setting objectives for your investment consultant

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Following its review of the investment consultant (IC) and fiduciary management (FM) markets, the CMA published draft remedies designed to improve the operation of these markets in March 2019. The remedies include a duty on trustees to set objectives for their IC, with the intention that setting objectives will enable trustees to better monitor the outcomes achieved. The objectives set by trustees should be closely linked to their scheme's investment strategy. In addition, the need for trustees and employers to work together to agree appropriate long-term funding targets was reiterated in TPR's recent annual funding statement (March 2019).

TPR will provide further guidance in due course, but in the meantime we identify some actions that trustees may wish to consider before setting objectives for their investment consultant. We also look at some examples of possible investment consultant objectives and consider some measurement approaches.

IC objectives should be linked to your scheme's overall strategy

If you have not recently refreshed your overall scheme objectives and investment strategy (including taking advice from your actuary and investment consultant), then this should be done before setting detailed objectives for your investment consultant. Scheme objectives ideally should relate to achieving full funding on a technical provisions basis and a longer-term journey plan, such as 'self-sufficiency' or 'buy-out', with target dates identified for their achievement. Your investment strategy will usually reflect a variety of factors, such as:

- Current scheme funding level – for example a scheme with a poor funding position may need to focus on protecting against any deterioration in its funding as well as growing the assets at a steady pace over time (and these of course may be mutually exclusive!);
- Sponsor health – a scheme with a very strong sponsor may be able to take more risk as the sponsor can be relied upon to provide additional support in the event of adverse circumstances. Conversely, a scheme with a weak sponsor will not have this safety net;
- Scheme size – the scale and complexity of the scheme are also relevant, as certain types of investments may only be accessible to the very largest schemes;
- Other factors – there are a variety of other issues that may also need to be considered. For example, the trustees' beliefs about active and passive management, risk tolerance, and uncertainties about future volumes of transfers out.

Setting objectives and measuring the performance of your investment consultant

Only when your scheme objectives and investment strategy are clear, will it be possible to set specific objectives linked to them for your IC. Due to the variable nature of schemes and their investment strategies, IC objectives will tend to be very scheme specific. Key amongst them are likely to be:

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- Progress against the agreed scheme objectives plus return and risk outcomes;
- The performance of underlying asset classes and individual asset managers.

Additional quantitative measures could include savings made with underlying managers and adherence to agreed consulting budgets.

When assessing outcomes against quantitative objectives such as the above, trustees should also take account of a range of qualitative factors when forming an overall view of their IC. Factors could include:

- The quality, timeliness and clarity of advice provided in areas such as:
  - Setting strategic objectives;
  - Liability hedging;
  - Return seeking asset portfolio construction;
  - The selection of asset managers.
- The quality, timeliness and clarity of performance reporting;
- The quality and stability of the IC's team and organisation, including the proactivity of the team.

Clearly some of the above will be purely 'numbers' based and will be required on a quarterly basis, with more detailed assessments annually and every three years. Others will require qualitative reviews of activity, perhaps undertaken at a high-level each year and in more detail every three years.

It is also vital for trustees to understand that there won't always be a perfect alignment between scheme performance and that of the IC. This might arise, for example, where advice given is not of high quality, timely and clear or where trustee boards do not act on advice given, or do not do so in a timely manner. Additional metrics can be developed to account for implementation 'slippage', for example what the outcomes would have been had the IC's recommendations had been accepted in full, although these measures can be complex to calculate and open to different interpretations. Where recommendations are frequently not acted upon or implementation takes too long, some trustee boards review their governance arrangements to ensure that they have the right consultant and/ or the need to add more experience and resources. The latter may potentially be achieved through introducing more investment skill to the trustee board, creating an investment committee or working group or even delegating more by moving to fiduciary management.

Conclusion

If boards do not have up-to-date scheme objectives and investment strategies, they will need to review these before setting detailed objectives for their IC. Where they are up-to-date a range of objectives can be designed specific to the scheme's context and the role undertaken by the IC. In all cases, careful consideration of the results, which can form an integral part of a trustee review of their IC, will be required to ensure that trustees understand the reasons for the outcomes and how to respond to them.

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