

Sixty second summary

Final CMA Order – when an exemption is no longer an exemption

Key messages

- On 10 June the final order was issued by the CMA in relation to their investigation into the investment consultancy and fiduciary management industry
- The wording in the final order has been amended such that the LGPS is now included in the list of schemes the order applies to, both in the definition of Trustees and a removal of the previous exemption (unlike other public service schemes)
- The new requirements include the need to set objectives for your investment consultant but may have wider reaching implications depending on interpretation of what advice is now regulated and what is deemed a fiduciary relationship
- Schemes have 6 months to comply with the new requirements

A recent Order¹ published by the Competition and Markets Authority has unexpectedly established new requirements affecting LGPS Funds. From December 2019, Funds will need to establish objectives for their investment consultants that are linked to their longer-term investment objectives. We have set out some initial considerations in this Summary to assist Committees.

Background

At the end of 2018, the Competition and Markets Authority (“CMA”) published its report following a review of the investment consulting and fiduciary management markets. Earlier this year, the CMA set out a draft Order, setting out requirements for the appointment and governance of fiduciary managers, and for pension scheme trustees to set objectives for their investment consultants. Although the draft Order did not impact directly on the LGPS, the final Order, which was released on 10 June, does now extend to the LGPS.

The new requirements

The CMA has stipulated in their Order that ‘Pensions Scheme Trustees’ (whose definition now includes LGPS Committees) should set objectives for their investment consultants. Such objectives (after also considering the accompanying explanatory note²):

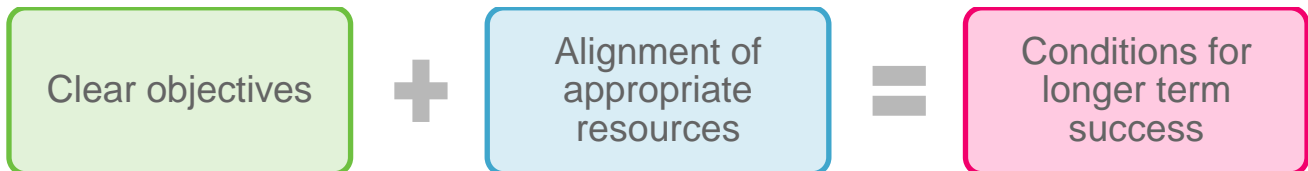
- Should be ‘closely linked’ to the Fund’s investment objectives
- Should be reviewed at least every three years and after a significant change to the investment strategy or objectives
- Should be established no later than 10 December 2019 (i.e. 6 months following the date of the final Order published by the CMA) or prior to appointment of a new investment consultant.

¹ <https://www.gov.uk/cma-cases/investment-consultants-market-investigation>

² https://assets.publishing.service.gov.uk/media/5cfe1dffed915d097f0f885d/Explanatory_note_investment_consultants.pdf

The importance of objectives

Establishing objectives is far from a new concept for the LGPS. Committees are required to set out their longer-term funding and investment objectives as part of their Funding and Investment Strategy Statements. We have long advocated these approaches as part of a well organised and well managed governance approach.



Provided that appropriate resources are allocated to support longer term goals, we believe the likelihood of achieving longer term success can be maximised through having clear objectives.

The extension to set objectives for investment consultants could be regarded as part of a natural progression towards all stakeholders being aligned to a common goal. Indeed, we believe that best practice would be to establish objectives for all key service providers supporting Funds in achieving their longer-term goals.

Establishing objectives for consultants

In their accompanying explanatory note, the CMA states that objectives for consultants should include a clear definition of the outcome expected and timescales for achieving this, and be reasonably achievable. In addition, objectives should enable the quality of services provided to be measurable, thereby supporting reporting.

By way of an example, an LGPS Fund may have the following investment objective:

- *“Maximise the returns from investments whilst keeping risk within acceptable levels”*

A corresponding objective for investment consultants may be to:

- *“Provide strategic investment advice to deliver the required investment returns from the Scheme’s investments, with as little risk as possible, to support full funding by 20XX and maintain stable and affordable contributions from the employers.”*

In practice, LGPS Funds will have funding and investment objectives that reflect their specific circumstances, and so objectives for consultants should also be Fund-specific.

Measuring success

One of the key challenges when attempting to measure success relative to longer term objectives is that traditional methods for assessing performance are typically short-term in nature and can sometimes neglect Fund-specific elements.

For example, the Pensions & Investment Research Consultants (“PIRC”) provides an analysis of investment returns across LGPS Funds on an annual basis. This study, which ranks Funds according to return achieved in a given time period, does not capture the fact that Committees will have established objectives, investment beliefs and timeframes that differ across Funds and so their individual risk and return requirements will differ. Indeed many LGPS Funds have adopted very different approaches in terms of their strategic asset allocation including employer specific investment strategies and views on diversification. Clearly, these choices will have a significant bearing on the return profile over different time periods, meaning a straight comparison between Funds does not provide a complete picture.

Learning from this, we suggest consideration is given to how consultants' performance relative to their objectives should be measured. In terms of the impact of strategic advice, for example, this should be measured having regard to the level of investment return and risk achieved over a suitable timeframe, and considering the impact of different market environments.

Wider implications of the new order

While the focus in this summary has been on the requirement to set objectives for investment consultants (not surprising given the authors) there may be wider reaching implications of the CMA Order. A significant part of the Order is focussed on fiduciary management services. This raises the question as to what is deemed to be a fiduciary relationship and how might some of the new LGPS pooling arrangements be viewed. The order may also impact what advice is now deemed to be regulated and therefore the requirement for Funds to take regulated advice. It will be important that Funds are able to evidence they are taking proper advice and that those giving the advice have appropriate regulatory authorisations where relevant.

This is still an emerging issue and we expect to follow up with further Sixty Second Summary updates once these positions are clarified and the implications for LGPS Funds are known.

Next steps

Committees will need to establish objectives for their consultants no later than 10 December 2019. To support this, we will be contacting our clients to raise awareness of the new requirements and to initiate discussions around potential objectives.

After this exercise, we believe a logical progression would be to consider setting objectives for all key service providers. The overarching aim to ensure that all key stakeholders are focussed on a common long-term goal.

Please speak to your Hymans Robertson Consultant if you would like to discuss the implications of the new requirements further.