Appendix 1-

Investment consultancy services

A wide range of investment consultancy services are available to trustees of occupational pension schemes. Depending on whether your scheme is DC or DB and the circumstances of your scheme, these services will differ.

In order to set strategic objectives for your adviser, you will first need to understand the services to which the objectives relate. As outlined in the introduction, only those areas that come within the legal definition[4] of investment consultancy services trigger the requirement for you to set strategic objectives, but as a matter of good governance we would encourage you to consider setting objectives for any additional services you receive.

Below we have listed some examples of investment consultancy services that trustees can receive for DB and DC schemes, together with a brief explanation of what these typically involve. These lists are not exhaustive and the requirements for the level of service provided will vary between schemes, trustee boards and the individual governance and support arrangements for those schemes

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4 The definition of investment consultancy services as set out in the CMA's Investment Consultancy and Fiduciary Management Market Investigation Order 2019.

Typical services available for DB schemes

Defining investment beliefs

This often involves a review of the trustee's investment preferences, informed by appropriate evidence and knowledge such as whether the trustee(s) prefer active or passive fund management, illiquid investments over liquid investment etc, and using these findings to agree a set of core investment beliefs that represent the trustee(s) preferences.

Investment strategy review

This involves a review of the nature and term structure of the pension scheme liabilities and advice on an appropriate asset allocation to adopt in order to best meet those liabilities, in light of objectives set by the trustees and considering the financial support that is available from the scheme's employer(s).

Risk modelling

This can involve the analysis of risk using a range of different tools and metrics, for example asset liability modelling and scenario/sensitivity analysis. It is frequently included as part of the investment strategy review service but can be tendered for and provided separately. In large schemes, a risk review by an independent third

Setting investment performance and risk targets

This involves taking the output from the investment strategy review and any associated risk modelling to set the performance and risk targets for the scheme.

Portfolio construction

This involves advice on how a portfolio of investments or investment funds could be constructed to best align with the proposed asset allocation strategy and the trustees' investment beliefs, allowing for the investment performance and risk targets set.

Investment manager selection

This process would aim to identify a list of managers, based on research and due diligence completed, that might be appropriate to include within the portfolio, individually or in combination, to meet the performance and risk targets set for all or part of the portfolio. This work would also include preparation and submission of appropriate due diligence materials and could include assistance with the tender

process, from drafting the invitation to tender, to reviewing the submissions made and attending manager interviews (and manager site visits).

Appointment of investment manager

The degree of service required is likely to depend to an extent on the type and structure of investment fund offered and the degree of discretion allowed. However, the service could involve advice (in relation to the investment elements) on the structure and terms and conditions of the fund mandates. In addition, it could involve advice in relation to the level and structure of any investment fees, the design of any performance fee elements and advice on the mandate guidelines, tolerances and restrictions to be applied.

Transition management

This would involve advice on any portfolio re-organisation or changes to investment managers to help ensure that the assets can be moved efficiently, with minimum costs and to limit 'out of market' exposure. This service could include advice on the use of derivatives to optimise the transition process.

Risk mitigation and risk transfer

This would involve advice on how different risks the scheme is exposed to could be mitigated, managed and/or transferred to another party.

Investment risk and performance monitoring

This would often include preparation of regular reports and information in relation to the performance of the investment managers invested in by the scheme and the risk exposures arising. This would also include advice in relation to the ongoing suitability of the investment strategy and the individual investment management arrangements. This could also include periodic reviews of whether the fees being paid continue to be appropriate.

Fiduciary manager selection

This process would aim to identify a list of fiduciary managers, based on research and due diligence completed, that might be appropriate to meet the trustees' requirements for the management and governance of all or part of the scheme's assets. This work would also include preparation and submission of appropriate due diligence materials and could include assistance with the tender process, from drafting the invitation to tender, to reviewing the submissions made and attending fiduciary manager interviews (and fiduciary manager site visits).

Fiduciary management monitoring

This would involve providing oversight of the performance of any fiduciary manager appointed by the trustees and considering their ongoing suitability to meet the requirements of the scheme. This would also include advice on whether any changes in the fiduciary manager or the remit of their mandate were necessary.

Provision of regulated advice

This would include the provision of written advice in relation to investments (as required under s36 of the Pensions Act 1995) and the review and preparation of the scheme's statement of investment principles (required under s35 of the Pensions Act 1995).

Governance structures

This would involve advice on the alternative ways in which investment and risk management might be governed, and the terms of reference and delegated responsibilities that might apply to each element of the governance structure.

Additional investment advice

This could be in relation to the selection and appointment of investment platform providers, custodians or sub-custodians or advice in relation to tactical asset allocation, structured equity or option strategies.

Trustee training

This could include a range of training from basic investment training on investment

duties and investment structures through to training on the implementation of complex derivative and risk management strategies.

Objectives for investment consultancy services

Setting adviser objectives

When in receipt of investment consultancy services, unless exempt, you must set objectives for the provider of this service. When setting these objectives, you should include how these will contribute to achieving the scheme's overall investment objectives. Where you engage with more than one adviser in respect of investments, you must set objectives for each respective adviser. You are not limited in the number of objectives you may set. It will likely be proportionate to set multiple objectives for your adviser, in accordance with the range of services you receive.

Trustees should also be aware that when they retain a fiduciary manager, they should be aware of the extent of investment services they receive from them as part of the overall engagement and they should set objectives for the investment services provided.
You may also wish to set a combination of short and long-term objectives, ensuring that the objectives are appropriate and achievable for the given time frame.

Adviser objectives can be quantitative and qualitative in their nature, for example these could be set in relation to investment performance delivered relative to the liabilities, adviser performance against service level agreements, communication skills, value for money and performance against specific tasks, such as asset transitions or investment manager selection exercises. Examples of the areas that objectives may cover are outlined in the DB and DC case studies later in this guidance.

In setting objectives for your investment adviser, you will want to receive their input to ensure that the objectives being set are consistent with the service being offered and are realistic. In obtaining your adviser's input, you should be aware of the potential for their input to be subject to conflicts of interest and you should be prepared to challenge their input. You should also consider whether to involve a third party to help you set those objectives.

Once objectives have been agreed, we would expect these to be signed off in accordance with your existing governance framework, ensuring that all members of the trustee board have sight of and, if relevant, agree with the adviser objectives that have been set and the ongoing monitoring process of these

Monitoring objective progress

When putting in place a set of performance objectives with your adviser, you should also consider the method and regularity for assessing your adviser's performance against these objectives. You should conduct reviews at least triennially and after any significant change to your scheme's investment strategy and objectives. Where you have set multiple objectives for your adviser and the timeframes for meeting them vary, you may also wish to consider ad-hoc reviews when you complete any significant pieces of work.

While you remain ultimately responsible for your scheme's overall investment objectives, it is important to acknowledge and understand the roles that you and your adviser(s) can have in determining whether or not these objectives are met. For example, trustees may decide not to act on advice received or delay acting on advice received, which could result in the value of the investment opportunity presented diminishing. Performance review sessions should be objective and consider evidence of how the adviser is meeting their

objectives with appropriate allowances for the impact of trustee decision-making and governance structures and the interaction with the trustees, alongside any other relevant external factors, on the outcome actually achieved.

You may wish to incorporate the review of your investment consultant's performance with the effectiveness review of your board.

Case studies

We have developed the following case studies to assist you in identifying the areas of investment consultancy services you should consider when setting objectives for your adviser.

Investment consultant objectivesand performance measurement (DB)

The trustees of the XYZ DB pension scheme had retained ABC Investment Consultants as their investment advisers for many years. XYZ was a full service client of ABC and any investment-related issues the scheme had were dealt with by ABC. Fees were generally charged on a time-cost basis but the fees for more significant items, like manager selection exercises and asset-liability modelling, were based around an agreed fixed fee scale or agreed separately in advance. The trustees acknowledged the following:

- Appropriate investment and risk management advice, in the absence of unlimited employer contributions, was the key driver in ensuring that members received their benefits in full and recognised that the service was of significant value to their scheme.
- The balance between an adviser providing advice and the trustee being the decision-maker added complexity to any assessment of "value added".
- There was a risk that the "potential value" of good advice could be lost due to the trustees being unable to make effective decisions in a timely manner or being unwilling to make a decision to the full extent of the advice provided.
- It was important to distinguish between the difference made by process driven improvements (arising, for example, from the impact on the funding level from employer deficit repair contributions) and value add driven improvements (arising, for example, from recommendation of investment managers that out-performed).
- It was difficult to define an appropriate period to measure and attribute performance given the potential for investment market volatility and general market noise to distort.
- It would be challenging to develop a robust framework that could work in all environments.
- They would also need to consider how the trustees' governance and decision making structures contributed to (investment) outcomes.
- Changes to their current governance arrangements should also be considered (for example, appointment of a professional trustee, creation of an investment committee or increasing the number and frequency of trustee meetings).

The trustees agreed to adopt a balanced scorecard approach, where performance against a number of clear objectives set for their investment consultant would be assessed using a combination of quantitative and qualitative measures.

The trustees looked at the services outlined as part of ABC's response to the invitation to tender that they had submitted a number of years previously and decided to group them under six key objectives that they would monitor:

1. Demonstration of value added.
2. Delivery of specialist processes.
3. Proactivity of advice.
4. Support with scheme management and compliance.
5. Relationship and service standards.
6. Support with additional matters arising.

The trustees acknowledged that short-term market movements and the trustees' and employer's business planning cycles could both distort and influence activity undertaken and agreed to monitor performance over both a one and three-year horizon, using different weights against each key objective.

The trustees were mindful that the investment activity required varied from time to time. They set out under each key objective the individual services they felt should be considered in forming a view on the investment adviser's performance against the main objective. The trustees did not assign weightings to the individual services under each objective as they recognised that not all services were required within each monitoring period.

The trustees shared their proposed performance monitoring framework with their investment consultant and included their proposal that the effectiveness of the trustees' governance and decision-making framework over the performance period, would also form part of the assessment. Following discussion and some revisions, the template set out in the table below was agreed.

The investment consultancy firm also outlined an offer to the trustees whereby an element of their fees (10%) would not be paid if their service did not meet a particular level and that a "bonus" fee (5%) would be paid if their service exceeded a particular higher level. The trustees were interested in this concept but were concerned about their ability to apply a consistent approach when assessing objectives qualitatively.

The trustees asked their consultant to prepare a further version of their template against which they set out what they believed "good" and "bad" service looked like.

Following further discussion and some revisions, the trustees agreed the template and the date at which the first assessment would take place. As part of their ongoing annual assessment cycle, the trustees and the investment adviser also agreed to consider whether any changes to the template or their investment governance structure were necessary.

Example scorecard

Case studies: Investment consultant objectives and performance measurement (DB)

Objective	I year	3 year
1. Demonstration of value added	**30%**	**30%**
• Help the trustees to deliver an investment return of liabilities + x% per annum measured over rolling N- year periods		

• Help the trustees to stabilise and improve the scheme's funding level over time • Increase the asset value of the scheme through their investment manager selection, research and recommendations and through their portfolio construction • Increase the asset value of the scheme through tactical and medium-term asset allocation • Enable the trustees to implement their scheme's investments on a more competitive fee basis through negotiation on implementation and periodic benchmarking of fees • Help the trustees to transition any assets between investment managers on a cost-effective basis • Help the trustees to implement an investment strategy which adds value through the integration of ESG (including climate change) and stewardship considerations in their investment manager appointments • Enable the trustees to access a wider range of opportunities and portfolios of assets (and/or build portfolios of assets) • Help the trustees to manage their scheme cashflows needs in a more cost-effective manner		
2. Delivery of specialist processes	**20%**	**30%**
• Complete asset liability modelling and scenario/sensitivity modelling using their in-house models (or proprietary modelling tools) • Help the trustees to decide on an appropriate risk and performance objective for the scheme • Help the trustees to develop and define their investment beliefs • Help the trustees to review their investment governance arrangements and terms of reference for any sub-committees or delegated authorities • Help the trustees to develop and maintain an appropriate framework to track progress against strategic objectives		
3. Proactivity of advice	**15%**	**5%**
• Advise the trustees on new investment opportunities or emerging risks • Advise the trustees on market pricing opportunities to mitigate or transfer risk • Deliver training to enable the trustees to engage with new investment opportunities, emerging risks or opportunities to transfer risk • Advise on any changes in the investment governance arrangements or delegated authorities which are necessary to enable the trustees to best access the emerging opportunities		
4. Support with scheme management and compliance.	**20%**	**20%**
• On a regular (quarterly) basis, monitor the performance of the scheme's investments relative to the liabilities and also the performance of the scheme's investment managers and any direct investment		

• Produce investment reports, briefing papers and investment advice in advance of trustee meetings and on a timely basis • Review and update as appropriate the scheme's statement of investment principles • Provide periodic written advice on direct investments held • Provide trustee training as required • Ensure compliance of the scheme's investment arrangements with developments in regulation and all legislation		
5. Relationship and service standards.	**10%**	**10%**
• Agree any changes of (named) investment consultant(s) and meeting cover with the trustees in advance • Maintain fees in line with tender submission • Agree fee budget with trustees for any significant piece of work • Clear understanding of the scheme's goals and objectives • Appropriate quality and quantity of resourcing to meet the needs and requirements of the scheme • Strong positive working relationship with the trustees • Work collaboratively with other advisers and provide effective support to trustees when engaging with other stakeholders • Appropriate management and mitigation of any conflicts of interest continued		
6. Support with additional matters arising	**5%**	**5%**
Provide advice and assistance to the trustees on any other issues arising (for example, following corporate transaction or significant corporate event impacting the pension scheme)		
Scheme's governance and decision-making framework	**Y/N**	**Y/N**
Has the governance structure and the level of engagement by the trustees helped or hindered the delivery of improved investment and funding outcomes?		