

**NORTHUMBERLAND COUNTY COUNCIL PENSION FUND  
Pension Fund Panel Meeting 28 February 2020**

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Dear Clare,

**Northumberland County Council Pension Fund**

**Action Required: With the recent publication of The Investment Consultancy and Fiduciary Management Market Investigation Order 2019 (the Order), the Competition and Markets Authority (the CMA) requires that occupational pension scheme trustees must set strategic objectives for their investment consultancy provider(s) by 10 December 2019. The Order also sets out those to which it applies. Until the Order was issued, it was understood that LGPS clients would be outside of the scope of the Order. However, as explained in the Scheme Advisory Board's briefing note, dated 1 August 2019, the Order, when finalised, extended its application to the LGPS. Consequently, the Scheme Advisory Board has stated that it would be prudent for authorities to assume that the requirement to set strategic objectives for the investment consultancy providers also will apply to the LGPS.**

**Further information is attached as an Appendix to this letter, including the Scheme Advisory Board's briefing note by way of background.**

In the absence of agreed objectives, and on the basis that the requirement to set objectives will apply to the LGPS, continuing to obtain Investment Consultancy Services (as defined in the Order), from 10 December 2019, would place the administering authority in breach and potentially liable to penalties. Given the short timeframe, therefore, we believe it is important to bring this matter to your early attention and, in this letter, we propose a simplified set of strategic objectives relating to the services to which the Order applies. We would welcome the opportunity to engage with you further before and/or after 10 December to refine and develop the objectives to meet your requirements. Ultimately, the onus rests with the administering authority of the Fund to set the objectives and we recognise that we do have a conflict of interest in proposing objectives against which we, as your adviser, would be measured. Given this, you may wish to take separate advice on the appropriateness of the objectives.



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We have worked on the basis that the strategic objectives for the investment consultancy provider should, as far as reasonably possible, align with the strategic objectives for the Fund. We believe that it can be difficult to measure the value added by investment advice as this is closely linked to the Fund's own decision-making (and to the timing of the implementation of those decisions). Nevertheless, it is good governance to assess your advisors and Mercer's investment monitoring and reporting (by way of a risk dashboard and/or quarterly performance reports) is, in our view, a good starting point to assist the Panel with understanding how key investment decisions have driven the development of the funding level and ultimately the progress towards the Fund's objectives. We appreciate that different clients will want to approach assessing their advisors in different levels of detail. So we anticipate the information required to do so will vary from a minimum compliance approach through to something more thorough. Either way, we will look to work with you to ensure the Panel has the necessary information required to make an assessment.

In addition, we have considered the draft guidance from The Pensions Regulator ("tPR"), which is referenced in the Scheme Advisory Board's briefing note. The Scheme Advisory Board understands that the MHCLG may come forward with some provisions for LGPS authorities, and the attached briefing note addresses this in more detail. It is therefore worth noting that whilst tPR's draft guidance does not specifically cover the LGPS, it does provide a useful guide in the absence of any specific LGPS regulation. However, we would note that tPR's consultation on the guidance has only recently been completed and finalised guidance is awaited. Given the 10 December 2019 deadline for implementation, we felt it important to write to you now to allow sufficient time to consider this matter.

It is expected that the objectives are signed off in accordance with the Fund's existing governance framework. We would anticipate that whilst Funds operate different governance models this is likely to include input from the Panel and Officers to ensure that the objectives are appropriate, and that the on-going process for monitoring is robust. **If you are in agreement with the objectives proposed in this letter, please sign and return a copy by email. Alternatively, if you wish to make changes before signing, please mark up these and send back a revised draft to me at your earliest convenience for review and further discussion.** Please be mindful of the deadline and allow time for discussion with Mercer to ensure the objectives are consistent and practical.

We look forward to engaging with you further on this topic and receiving your response to the proposed strategic objectives. In the meantime, please let me know if you have any questions.

Yours sincerely

Susan Greenwood



## **Strategic Objectives for Investment Consultancy Services:**

### **Northumberland County Council Pension Fund (“*the Fund*”)**

Northumberland County Council, in its capacity as LGPS administering authority (“*the Scheme Manager*” as defined in the Public Service Pensions Act 2013), has appointed Mercer Limited (“*the IC Provider*”) to provide Investment Consultancy Services (as defined in The Investment Consultancy and Fiduciary Management Market Investigation Order 2019 (“*the Order*”)).

This document sets out the strategic objectives (“*the Objectives*”) against which the Scheme Manager will monitor the performance of the IC Provider in compliance with the Order (and, to the extent applicable, any superseding legislation).

The Objectives may be revised at any time but should be reviewed at least every three years, and after any significant change to the Scheme Manager’s investment strategy and objectives.

### **The Fund’s Overall Objective**

The Scheme Manager has set an overall objective for the Fund (“*the Fund’s Overall Objective*”) to achieve a long term return on the Fund’s assets which:

- ensures that, together with employer and member contributions, the Fund can meet its long term liabilities; and
- aims to maximise returns within acceptable risk parameters

The Scheme Manager has set the Objectives shown below for the IC Provider which will, if well executed, contribute towards achieving the Fund’s Overall Objective:

#### **1. Alignment of investment consultancy services with the Fund’s Overall Objective**

The IC Provider should take into account the Fund’s Overall Objective above and, in doing so, will give due consideration to relevant circumstances of the Fund. Those relevant circumstances include, but are not limited to, the contributions policy, developments in the funding level of the Fund from whatever cause, the tolerance for investment risk of the Scheme Manager and the Fund’s employers, economic and market conditions and outlook, and ancillary objectives and requirements including the responsibilities of the Scheme Manager to consider environmental, social and governance (ESG) factors (including climate change) and stewardship risks.

#### **2. Investment strategy objective**

Where applicable, the IC Provider should guide the Scheme Manager in determining appropriate investment objectives, appropriate levels of investment risk, and an appropriate and diversified investment strategy. In addition, the IC Provider should advise the Scheme Manager on new investment opportunities and emerging risks and periodically propose amendments to the investment strategy where appropriate. Investment strategy advice should contribute to the Fund’s Overall Objective by way of either improved performance and/or of management of investment risk over the long term and also reflecting the Fund’s cashflow position and minimising the risk of forced disinvestment.



**3. Investment manager selection objective**

Under the Government's pooling agenda it is expected that the IC Provider will have less input into manager selection advice going forward but where appropriate, the IC Provider should make recommendations on the appointment and retention of appropriate investment managers and on portfolio construction with those managers' strategies and funds, consistent with the Fund's Overall Objective and the chosen investment strategy. As far as is practical within the constraints of pooling, the IC Provider should recommend investment managers and/or pool sub funds for appointment and retention that the IC Provider believes have a high probability of achieving the objective set for the investment manager after fees over a market cycle. Manager selection therefore, should contribute to implementing the investment strategy of the Scheme Manager by way of either managing risk and/or achieving or beating the long-term return expected.

**4. Implementation objective**

The IC Provider should assist with achieving timely and cost-effective implementation of the Scheme Manager's investment decisions where appropriate.

**5. Investment Strategy Statement**

The IC Provider should provide guidance on any matters in respect of which the Scheme Manager is required by law or best practice guidance to seek advice in relation to the preparation or revision of its Investment Strategy Statement.

**6. Monitoring objective**

The IC Provider should monitor and assist with measuring the success of the Scheme Manager's chosen investment strategy and investment manager structure against the Fund's Overall Objective.

**7. Merger objective**

The IC Provider should assist, where appropriate, in the efficient implementation of the planned merger of the Fund with Tyne and Wear Pension Fund, having due regard to the uncertainty surrounding whether and when merger will take place.

**8. Value for money objective**

The IC Provider services to support the Fund shall be proportionate and competitive in terms of costs relative to our peer group.

The Scheme Manager acknowledges that the IC Provider's acceptance of the Objectives set out herein shall not create binding legal rights, obligations or guarantees, in respect of investment consultancy services to be provided by the IC Provider. The provision of investment consultancy services by the IC Provider shall be governed by separate engagement documentation agreed between the Scheme Manager and the IC Provider. To the extent that additional services shall be required to be performed by the IC Provider by virtue of the Objectives, this shall be documented formally by the parties.



Signed for and on behalf of Northumberland County Council

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Date

Signed for and on behalf of Mercer

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Date



## **Appendix 1 - Background Information on the CMA Order and its impact on the LGPS**

### **1. Competition and Markets Authority – Investment Consultancy and Fiduciary Management Market Investigation Order 2019**

This paper provides an overview of the Competition and Markets Authority (CMA) review of the investment consulting (IC) and fiduciary management (FM) markets and the potential application to the Local Government Pension Scheme (LGPS). This paper sets out, at a high level, our understanding of the implications of the Order based on our review and conversations with leading industry parties. However, we are not legal advisers and clients will need to form their own views on how the Order impacts them, seeking their own legal advice as necessary.

### **2. Background**

In September 2017, following a reference from the Financial Conduct Authority, the CMA commenced a market investigation of the IC and FM markets, resulting in a final report being issued in December 2018. The CMA identified a number of positive market features but also proposed a package of measures designed to enhance the workings of the markets. A consultation was initiated the CMA issued a Final Order in June 2019 to implement the measures.

### **3. CMA Order**

There are a number of detailed measures contained within the Order but, at a high-level, the two key requirements are:

- That, in certain circumstances, trustees of occupational pension schemes who appoint, or have appointed, a Fiduciary Manager must run a competitive tender process for those services (Remedy 1).
- A requirement for occupational pension scheme trustees to set strategic objectives for their IC provider(s) by no later than 10 December 2019 (Remedy 7).

The Order sets out those to which it applies. Until the publication of the Order, it was anticipated that the LGPS would be excluded from the Order and it was a surprise to see the LGPS specifically **included** in the list of pension schemes to which the Order applied. This has raised concern within the LGPS community, specifically around the role of the newly formed asset pools which could in certain circumstances, be classified as FM providers.

### **4. DWP Consultation**

On 29 July 2019, the Department for Work and Pensions (DWP) issued a consultation on draft regulations that, if passed, will bring the Order into pensions legislation and supersede the Order. This consultation did include specific mention of the LGPS, indicating that the DWP regulations would not apply to the LGPS, and specifically that the LGPS is only in scope for Remedy 7. However, regulations covering Remedy 7 would be the responsibility of the Ministry of Housing, Communities and Local Government (MHCLG) rather than the DWP.



## 5. Impact on the LGPS

Given the commentary within the DWP consultation, it appears that the only Remedy applicable to the LGPS is the requirement for Administering Authorities to set strategic objectives for their IC provider. This has been confirmed to Mercer by senior officials at the Local Government Association, who also confirmed that they have written undertakings from the CMA that they do not consider the LGPS to be in scope for Remedy 1.

The LGPS Scheme Advisory Board issued a briefing note in early July, which was revised on 1 August, to take account of the DWP consultation (attached as an appendix to this document) which appears to confirm this. It is understood that the MHCLG will be looking to issue draft regulations in the coming months.

### Additional related implications

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, as currently written, contain a requirement for LGPS Administering Authorities to take “proper advice” when setting their investment strategies. One of the outcomes from the CMA’s market investigation was its recommendation that Her Majesty’s Treasury (HMT) consults on extending the FCA’s regulatory perimeter to include more activities of investment consultants. When issuing its draft regulations, the DWP indicated that it is expected that HMT will consult later this year on the necessary amendments to legislation.



**Appendix 2 - The Pension Regulator’s example Balanced Scorecard (DB)**

Objective	
1	<b>Demonstration of value added</b>
	<ul style="list-style-type: none"> <li>• Help the trustees to deliver an investment return of liabilities + X% per annum measured over rolling N-year periods</li> <li>• Help the trustees to stabilise and improve the scheme’s funding level over time</li> <li>• Increase the asset value of the scheme through their investment manager selection, research and recommendations and through their portfolio construction</li> <li>• Increase the asset value of the scheme through tactical and medium term asset allocation</li> <li>• Enable the trustees to implement their scheme’s investments on a more competitive fee basis through negotiation on implementation and periodic benchmarking of fees</li> <li>• Help the trustees to transition any assets between investment managers on a cost-effective basis</li> <li>• 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</li> <li>• Enable the trustees to access a wider range of opportunities and portfolios of assets (and/or build portfolios of assets)</li> <li>• Help the trustees to manage their scheme cashflows needs in a more cost-effective manner</li> </ul>
2	<b>Delivery of specialist services</b>
	<ul style="list-style-type: none"> <li>• Complete asset liability modelling and scenario/sensitivity modelling using their in-house models (or proprietary modelling tools)</li> <li>• Help the trustees to decide on an appropriate risk and performance objective for the scheme</li> <li>• Help the trustees to develop and define their investment beliefs</li> <li>• Help the trustees to review their investment governance arrangements and terms of reference for any sub-committees or delegated authorities</li> <li>• Help the trustees to develop and maintain an appropriate framework to track progress against strategic objectives</li> </ul>
3	<b>Proactivity of advice</b>
	<ul style="list-style-type: none"> <li>• Advise the trustees on new investment opportunities or emerging risks</li> <li>• Advise the trustees on market pricing opportunities to mitigate or transfer risk</li> <li>• Deliver training to enable the trustees to engage with new investment opportunities, emerging risks or opportunities to transfer risk</li> <li>• 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</li> <li>•</li> </ul>

<b>4</b>	<b>Support with scheme management and compliance</b>
	<ul style="list-style-type: none"> <li>• On a regular (quarterly) 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</li> <li>• Produce investment reports, briefing papers and investment advice in advance of trustee meetings and on a timely basis</li> <li>• Review and update as appropriate the scheme’s statement of investment principles</li> <li>• Provide periodic written advice on direct investments held</li> <li>• Provide trustee training as required</li> <li>• Ensure compliance of the scheme’s investment arrangements with the regulations</li> </ul>
<b>5</b>	<b>Relationship and service standards</b>
	<ul style="list-style-type: none"> <li>• Agree any changes of (named) investment consultant(s) and meeting cover with the trustee in advance</li> <li>• Maintain fees in line with tender submission</li> <li>• Agree fee budget with trustees for any significant piece of work</li> <li>• Clear understanding of the scheme’s goals and objectives</li> <li>• Appropriate quality and quantity of resourcing to meet the needs and requirements of the scheme</li> <li>• Strong positive working relationship with the trustees</li> <li>• Work collaboratively with other advisers and provide effective support to trustees when engaging with other stakeholders</li> <li>• Appropriate management and mitigation of any conflicts of interest</li> </ul>
<b>6</b>	<b>Support with additional matters arising</b>
	<ul style="list-style-type: none"> <li>• Provide advice and assistance to the trustee on any other issues arising (for example, following corporate transaction or significant corporate event impacting pension scheme)</li> </ul>
	<b>Scheme’s governance and decision making framework</b>
	<ul style="list-style-type: none"> <li>• Has the governance structure and the level of engagement by the trustee helped or hindered the delivery of improved investment and funding outcomes</li> </ul>

Source: Adapted from The Pensions Regulator’s “A Trustee Guide to Setting Objectives for Providers of Investment Consultancy Services (July 2019)”